March 12, 2020

Financial Reporting Center –
Long-Duration Contracts Issued by Insurance Entities

Working Draft:

Targeted Improvements to Long-Duration Contracts Implementation Issue

Issue #11D: Upon adoption of FASB ASU 2018-12, is it permissible for an entity to change its accounting policy for all products for including the cost of reinsurance in loss recognition testing?

Wording to be Included in the Audit and Accounting Guide: Life and Health Insurance Entities

Cost of reinsurance (in a net debit, or asset position)

1. FASB ASC 944-605-30-4 states, "The difference, if any, between amounts paid for a reinsurance contract and the amount of the liabilities for policy benefits relating to the underlying reinsured contracts is part of the estimated cost to be amortized."

2. Paragraphs 35-14 and 35-15 of FASB ASC 944-605 state:

> Amortization of the estimated cost of reinsurance of long-duration contracts that meets the conditions for reinsurance accounting depends on whether the reinsurance contract is long-duration or short-duration. The cost shall be amortized over the remaining life of the underlying reinsured contracts if the reinsurance contract is long-duration or over the contract period of the reinsurance if the reinsurance contract is short-duration.
>
> The assumptions used in accounting for reinsurance costs shall be consistent with those used for the reinsured contracts.

<u>Cost of reinsurance (in a net debit, or asset position) – Long-duration contracts</u>

3. Prior to the adoption of FASB ASU 2018-12: *Targeted Improvements to the Accounting for Long-Duration Contracts*, some insurance entities apply an accounting policy that subjects the cost of reinsurance (in a debit, or asset position) to recoverability assessment via premium deficiency (i.e. loss recognition) testing. For these companies, the cost of reinsurance was tested together with the deferred acquisition costs and the underlying contracts at the level of aggregation that loss recognition testing is performed.

4. Other entities apply an accounting policy that treats the cost of reinsurance as a "prepaid expense", providing coverage/benefit for the life of the underlying contracts. There is no recoverability test for a prepaid expense.

5. FASB ASC 944-30-35-63 (marked to show amendments from FASB ASU 2018-12) states, "Unamortized deferred acquisition costs for short-duration contracts and the present value of future profits continue to be subject to premium deficiency testing in accordance with the provisions of Subtopic 944-60."

6. FASB ASC 944-60-15-5 (marked to show amendments from FASB ASU 2018-12) states:

   The guidance in the Long-Duration Contracts Subsections of this Subtopic applies to long-duration contracts, except for the liability for future policy benefits for traditional and limited-payment contracts subject to the guidance in paragraph 944-40-25-11 ~~including limited payment and universal life type contracts~~. Paragraph 944-30-35-63 specifies that the present value of future profits relating to insurance (including traditional and limited-payment) and reinsurance contracts acquired is subject to premium deficiency testing in accordance with the provisions of this Subtopic (see paragraph 944-805-35-3). See the Long-Duration Contracts Subsection of Section 944-20-15 for a discussion of what constitutes a long-duration contract.

7. FASB ASC 944-60-25-7 (marked to show amendments from FASB ASU 2018-12) states:

   Original policy benefit assumptions for certain long-duration contracts ordinarily continue to be used during the periods in which the **liability for future policy benefits** is accrued under Subtopic 944-40. However, actual experience with respect to investment yields, **mortality, morbidity**, terminations, or expenses may indicate that existing contract liabilities, together with the present value of future gross premiums, will not be sufficient to do both of the following:

   a. Cover the present value of future benefits to be paid to or on behalf of policyholders and settlement costs~~and **maintenance costs**~~ relating to a block of long-duration contracts
   b. Recover unamortized present value of future profits~~**acquisition costs**~~.

8. FASB ASU 2018-12 eliminated premium deficiency testing for the liability for future policy benefits for traditional and limited pay products, but it remains required for the present value of future profits under the guidance in FASB ASC 944-30-35-63. ASU 2018-12 did not change the guidance on premium deficiency testing for all other long-duration products other than to (a) specifically remove maintenance costs and (b) exclude the requirement to recover unamortized acquisition costs, as noted in FASB ASC 944-60-25-7.

9. FinREC believes if an entity included the cost of reinsurance (in a net debit or asset position) in premium deficiency testing prior to the adoption of FASB ASU 2018-12, upon the adoption of ASU 2018-12 the entity should continue to apply that accounting policy. Similarly, FinREC believes that an entity that excluded the cost of reinsurance in premium deficiency testing prior to the adoption of FASB ASU 2018-12, should also continue to apply that accounting policy. FinREC believes that if an entity decides to change its accounting policy with respect to the treatment of cost of reinsurance (in a net debit, or asset position), it would be required to be accounted for as a change in accounting principle and be subject to the provisions of FASB ASC 250, *Accounting Changes and Error Corrections*, rather than the transition provision of ASU 2018-12. In accordance with FASB ASC 250-10-45-2b, an entity should justify such an accounting policy change is preferable.

Comments should be received by May 15, 2020, and sent by electronic mail to Kim Kushmerick at kim.kushmerick@aicpa-cima.com, or you can send them by mail to attention: Kim Kushmerick, 1345 Avenue of the Americas, New York, N.Y., 10105.