Working Draft

Targeted Improvements to Long-Duration Contracts Implementation Paper

Issue #4C: **Retrospective adoption of market risk benefits guidance and the effect on the historical amortization of acquisition costs.**

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

Deferred Acquisition Costs – Modified Retrospective Transition

1. FASB 944-40-65-2 states,

> The following represents the transition and effective date information related to Accounting Standards Update No. 2018-12, *Financial Services – Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts:*
>
> **Liability for future policy benefits and deferred acquisition costs**
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> c. At the transition date, an insurance entity shall apply the pending content that links to this paragraph about the liability for future policy benefits and deferred acquisition costs (and balances amortized on a basis consistent with deferred acquisition costs, either as required by this Topic or as a result of an accounting policy election) to contracts in force on the basis of their existing carrying amounts at the transition date and by using updated cash flow assumptions, adjusted for the removal of any amounts in accumulated other comprehensive income.
>
> **Market risk benefits**
>
> f. At the beginning of the earliest period presented (that is, the transition date), an insurance entity shall apply the pending content that links to this paragraph on market risk benefits by means of retrospective application to all prior periods. […]

2. FASB ASC 944-40-65-2 does not specify whether to apply the retrospective transition guidance for market risk benefits before or after the modified retrospective transition guidance for the liability for future policy benefits, deferred acquisition costs, and balances amortized on a basis consistent with deferred acquisition costs. For example, when entities apply retrospective adoption of the new measurement and recognition guidance for market risk benefits, the change in measurement of certain benefit features in historical periods would change the present value of the estimated gross profits (EGPs), which were the basis for the amortization of certain deferred acquisition costs. FinREC believes an entity could either:

a. Revise the historical DAC amortization to reflect the change in the present value of EGPs as a result of the retrospective adoption of the market risk benefit guidance by applying the retrospective transition guidance for market risk benefits (FASB ASC 944-40-65-2f), establishing a new existing carrying amount for DAC to be used in the modified retrospective DAC transition guidance (ASC 944-40-65-2c). Any resulting change should be recognized at transition as an adjustment to retained earnings, or
b. Retain the existing DAC balances by applying the modified retrospective DAC transition guidance to the existing carrying amount for DAC without any revisions as a result of applying the retrospective transition guidance for market risk benefits.

FinREC believes entities should disclose their election related to the application of transition guidance for market risk benefits and DAC as a component of the qualitative and quantitative information in accordance with paragraphs 2g and 2h of FASB ASC 944-40-65.

3. If an insurance entity elects to revise historical DAC in accordance with paragraph 2a, FinREC believes the entity should remeasure the pretransition EGPs (amount and pattern), including any impact of changes in the amortization period resulting from applying the definition of the contract period within FASB ASC 944-40-35-8B[1].

4. If an insurance entity elects to retain the existing DAC balances in accordance with paragraph 2b, FinREC believes the entity should record through income in the period subsequent to transition any impact resulting from applying the definition of the contract period within FASB ASC 944-40-35-8B. If there is no remaining contract holder account balance at transition (either on an individual contract basis or on a grouped contract basis, as elected based on FASB ASC 944-30-35-3A), FinREC believes the insurance entity should immediately amortize any remaining DAC balance through income in the period subsequent to transition.

5. FinREC believes the insurance entity should apply the accounting policy election in paragraph 2 on an entity-wide basis.

Comments should be received by November 17, 2021, 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.

[1] Paragraph 59 of the Amortization of Deferred Acquisition Costs section of Appendix G: *FASB ASU No. 2018-12: Financial Services — Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts, Accounting Implementation Papers*, of the AICPA Audit and Accounting Guide: *Life and Health Insurance Entities*, provides guidance on the adoption of FASB ASC 944-40-35-8B.