Insurance Expert Panel

Highlights of the December 11-12, 2019, Meetings

The Insurance Expert Panel met on December 11 for an Expert Panel meeting, and the morning of December 12 with the SEC Staff (the Staff).

The Expert Panel discussed the following topics:

1. **FASB ASU 2018-12: *Targeted Improvements to Long-Duration Contracts*, Implementation Issues:** The Expert Panel discussed the following implementation issues:
    a. #9D**:** DAC Amortization - Expected Term of the Contract
    b. #11A/11B/11C – Ceded Reinsurance
    c. #11D – Cost of Reinsurance – Premium Deficiency

    Below is the status of implementation issues that have been discussed by FinREC:
    a. Issues discussed at the November 2019 FinREC meeting:
        i. #2: Loss Recognition Unit of Account – posted for informal comment on the LDTI issues webpage, comments due back by February 10, 2020: https://www.aicpa.org/content/dam/aicpa/interestareas/frc/industryinsights/downloadabledocuments/brd/targeted-improvements-to-long-duration-contracts-implementation-issue-2.pdf
        ii. #4AB: Market Risk Benefits - Considerations related to transition, including the use of hindsight and clarification on the application of the fair value framework of FASB ASC 820 to the initial and subsequent measurement of market risk benefits at fair value.– posted for informal comment on the LDTI issues webpage, comments due back by April 10, 2020: https://www.aicpa.org/content/dam/aicpa/interestareas/frc/industryinsights/downloadabledocuments/brd/targeted-improvements-to-long-duration-contracts-implementation-issue-4ab.pdf
        iii. #9ABC DAC amortization including:
            1. Considerations for evaluating whether the amortization on a constant-level basis for grouped contracts approximates straight-line amortization on an individual basis
            2. Interaction of the liability for future policy benefits cash flow assumption updates and DAC amortization assumption updates
            3. Updating of DAC experience as of the beginning of the period or end of period

            posted for informal comment on the LDTI issues webpage, comments due back by April 10, 2020: https://www.aicpa.org/content/dam/aicpa/interestareas/frc/industryinsights/downloadabledocuments/brd/targeted-improvements-to-long-duration-contracts-implementation-issue-9abc.pdf

    b. Issues discussed at the January 2020 FinREC call:

i. #1: Claim Liabilities - Claim liabilities associated with long duration traditional insurance contracts, interaction with liability for future policy benefits **-** posted for informal comment on the LDTI issues webpage, comments due back by April 10, 2020: https://www.aicpa.org/content/dam/aicpa/interestareas/frc/industryinsights/downloadabledocuments/brd/targeted-improvements-to-long-duration-contracts-implementation-issue-1.pdf

ii. #8: Updating cash flow assumptions in the net premium ratio - posted for informal comment on the LDTI issues webpage, comments due back by April 10, 2020: https://www.aicpa.org/content/dam/aicpa/interestareas/frc/industryinsights/downloadabledocuments/brd/targeted-improvements-to-long-duration-contracts-implementation-issue-8.pdf

The status of FASB ASU 2018-12 implementation issues can be found on the insurance expert panel webpage at: https://www.aicpa.org/interestareas/frc/industryinsights/long-duration-insurance-accounting-issues.html

2. **FASB ASU 2016-13: *Financial Instruments – Measurement of Credit Losses on Financial Instruments*, Implementation Issues**:
   a. The following insurance specific implementation issues are posted for informal comment, with comments due back by February 10, 2020:
      i. Issue #34: Considerations Related to ASC Topic 326: Financial Instruments - Credit Losses, for Reinsurance Recoverables

      ii. Issue #44: Considerations Related to ASC Topic 326: Financial Instruments - Credit Losses, for Premiums Receivable

The status of FASB ASU 2016-13 implementation issues can be found on the CECL issues webpage at: https://www.aicpa.org/interestareas/frc/industryinsights/credit-loss-standard-issues.html

3. **Statutory Practice Issues:** The Expert Panel discussed several issues from the Summer and Fall 2019 NAIC National Meetings:
   a. **FASB ASU 2018-12: Targeted Improvements to the Accounting for Long-Duration Contracts Issued by Insurance Companies:** During the Summer 2019 NAIC meeting, the Statutory Accounting Principles Working Group (SAPWG) adopted a conclusion to reject the guidance in FASB ASU 2018-12: *Targeted Improvements to the Accounting for Long-Duration Contracts*, including all disclosures.

   b. **SSAPs 68 and 97 Goodwill Reconsiderations** – During the Fall 2019 NAIC meeting, the SAPWG adopted guidance effective for year-end 2019 that clarifies that goodwill resulting from an acquisition of a subsidiary controlled affiliate (SCA) where goodwill is pushed down is included in the 10% goodwill admittance test based on the acquiring entity's capital and surplus. The adopted guidance applies in narrower situations than previously thought. The working group re-exposed additional goodwill-related issues with a comment period that ends January 31, 2020, specifically:
      - SAPWG Ref #2019-12 - Issue: ASU 2014-17, Business Combinations – Pushdown Accounting, a Consensus of the FASB Emerging Issues Task Force - re-exposed agenda item to allow additional time for specific examples of pushdown accounting to be provided by interested parties, as well as consider comments received on pushdown.
      - SAPWG Ref #2019-14 - Issue: Attribution of Goodwill - Re-exposed the agenda item requesting comments on the proposed disclosure for the "assignment" of goodwill.
      - SAPWG Ref #2019-32 - Issue: Look-Through with Multiple Holding Companies - Exposed revisions clarify that a more-than-one holding company structure is permitted as a look-through if each of the holding companies within the structure complies with the requirements in SSAP No. 97.

   c. **SSAP No. 101: Income Taxes**. During the Summer 2019 NAIC meeting, SAPWG adopted extensive changes to SSAP 101 which focus on two areas:
      - Necessary "housekeeping" revisions to reflect the Tax Cuts and Jobs Act, particularly in the Q&A's illustrative examples (#2019-09), and more substantively,

- New clarifying guidance related to the issue of the reversal patterns of deferred tax items and admissibility under paragraph 11.c. (#2019-10).

The revisions are effective as of December 31, 2019, and any change in income tax balances as a result of implementing the guidance is to be accounted for as a change in accounting principle.

d. **Principle Based Reserves (PBR) for life insurance–** The NAIC adopted principle-based reserving (PBR) starting on January 1, 2017, with a three-year transition period where PBR is optional until PBR becomes required as of January 1, 2020. PBR results in life insurers using a PBR methodology for life insurance products, instead of the current formulaic reserve computation method. It was discussed that NY has developed its own version of PBR, which is out for exposure in December 2019.

e. **PBR for Variable Annuities –** The NAIC adopted PBR and RBC for variable annuities which can be early adopted for year-end 2019, and is mandatory as of January 1, 2020. NY is also developing its own version of VA reserving requirements.

4. AICPA Auditor Reporting Task Force – In August 2019, the AICPA Auditing Standards Board (ASB) released an exposure draft, Proposed Statement on Auditing Standards: *Amendments to AU-C Section 800, 805, AND 810 to Incorporate Auditor Reporting Changes from SAS No. 134*, with a comment period that ended October 28, 2019. The exposure draft can be found on the ASB webpage at:

https://www.aicpa.org/content/dam/aicpa/research/exposuredrafts/accountingandauditing/downloadabledocuments/20190828a/20190828a-ed-sas-auc-800-amendments.pdf

During the January 2020 ASB meeting, a finalized Statement on Auditing Standards (SAS) was approved to conform the following AU-C sections to SAS No. 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements:

- Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*,
- Section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, and
- Section 810, *Engagements to Report on Summary Financial Information*.

The final SAS does NOT include a change from the dual opinion on the statutory financial statements.

SAS No. 139: *Amendments to AU-C Sections 800, 805, and 810 to Incorporate Auditor Reporting Changes From SAS No. 134*, is expected to be released in March 2020 and will be effective for reports on periods ending on or after December 15, 2020. Early implementation is not permitted.

On December 12, 2019 the SEC Staff discussed the following topics of interest with the Expert Panel:

1. **Disclosure Observations:**

   a. **FASB ASU 2015-09: Disclosures about Short-Duration Contracts** – The Staff discussed observations related to disclosures required by FASB ASU 2015-09.

   As noted at the December 2017 meeting, the Staff reminded the Expert Panel that the objective of these disclosures as explained in BC2 of ASU 2015-09, is "…to increase transparency of significant estimates made in measuring the liability for unpaid claims and claim adjustment expenses, improve comparability by requiring consistent disclosure of information, and provide financial statement users with information to facilitate analysis of the amount, timing, and uncertainty of cash flows arising from contracts issued by insurance entities and the development of loss reserve estimates."

      i. **Level of Disaggregation:** The Staff expects insurers to provide sufficient information to ensure that users are able to understand estimates for the liability for unpaid claims and claim adjustment expenses. During 2019 and 2018, a common comment letter theme was the need for further disaggregation in the loss development tables. Some examples where further disaggregation of the loss development table was requested include situations where the registrant provided one combined table for short-tailed insurance business, such as automobile physical damage, and long-tailed insurance, such as automobile liability, or combining multiple types of insurance that have significantly different characteristics, such as aviation insurance, commercial umbrella, and professional liability coverage. The Staff also noted that separate explanations should be provided for favorable and unfavorable experience for each group that might net within a segment.

ii. **Claim Frequency and total incurred-but-not-reported liabilities plus expected development on reported claims:** The Staff mentioned that in accordance with FASB ASC 944-40-50-4D, cumulative claim frequency information and IBNR amounts should be included in the disclosures about incurred claim development (as illustrated in FASB ASC 944-40-55-9E) and not within the paid part of the claims development table.

iii. **Loss Reserve Development**: The Staff mentioned that it is looking for improved disclosures related to the explanation of the underlying causes of changes in loss development. Registrants should provide explanations of the ultimate underlying cause of favorable or unfavorable development, not simply mentioning the particular accident years and lines of business impacted. Quantification may be needed for readers to understand.

iv. **Treatment of ceded reinsurance in paid section of loss development table**: FASB ASC 944-40-50-4B requires that claim development by accident year be presented on a net basis after risk mitigation through reinsurance for both incurred claims and allocated claim adjustment expenses, and paid claims and allocated claim adjustment expenses.

The Staff asked how insurers in practice present, in the paid section of the table, situations where claim payments have been made on direct claims at year end, but the insurer has not yet received reimbursements for the reinsured claims. In the fact pattern the staff encountered, they thought it appropriate to include paid claims and allocated claim adjustment expenses net of reinsurance even if the recoverable had not been collected during the same year. The Expert Panel will determine whether other presentations are prevalent in practice.

b. **Non-GAAP Measures:** The Staff mentioned areas that require improvement:

i. **Prominence:** Item 10(e)(1)(i)(A) of Regulation S-K requires that when a registrant presents a non-GAAP measure it must present the most directly comparable GAAP measure with equal or greater prominence. As explained in SEC Compliance and Disclosure Interpretation (C&DI) Question 102.10, presenting a full income statement of non-GAAP measures or presenting a full non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures, would each be considered an example of presenting non-GAAP measures as more prominent than comparable GAAP.

ii. Segment disclosures: In accordance with SEC C&DI Question 104.01, segment measures required under FASB ASC 280 are not considered non-GAAP measures.

SEC C&DI Question 104.01 states:

> Question: Is segment information that is presented in conformity with Accounting Standards Codification 280, pursuant to which a company may determine segment profitability on a basis that differs from the amounts in the consolidated financial statements determined in accordance with GAAP, considered to be a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?
>
> Answer: No. Non-GAAP financial measures do not include financial measures that are required to be disclosed by GAAP. Exchange Act Release No. 47226 lists “measures of profit or loss and total assets for each segment required to be disclosed in accordance with GAAP” as examples of such measures. The measure of segment profit or loss and segment total assets under Accounting Standards Codification 280 is the measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segment and assessing its performance

The Staff also explained that the reconciliation of segment profit or loss measures to the consolidated financial statements as required in FASB ASC 280 would be considered GAAP, but this consolidated measure would be considered non-GAAP outside of the segment footnote (such as the presentation of the total non-GAAP segment profit or loss measure on a consolidated basis in the MD&A).

SEC C&DI Question 104.04 states:

> Question: In the footnote that reconciles the segment measures to the consolidated financial statements, a company may total the profit or loss for the individual segments as

part of the Accounting Standards Codification 280 required reconciliation. Would the presentation of the total segment profit or loss measure in any context other than the Accounting Standards Codification 280 required reconciliation in the footnote be the presentation of a non-GAAP financial measure?

Answer: Yes. The presentation of the total segment profit or loss measure in any context other than the Accounting Standards Codification 280 required reconciliation in the footnote would be the presentation of a non-GAAP financial measure because it has no authoritative meaning outside of the Accounting Standards Codification 280 required reconciliation in the footnotes to the company's consolidated financial statements.

iii. **Operating Statistics and Ratios:** The Staff explained that operating statistics or ratios calculated exclusively from amounts presented in accordance with GAAP are not non-GAAP measures (e.g., the calculation of a specific ratio that uses a GAAP amount divided by another GAAP amount). It was also noted that statistical/operational measures that contain measures that are not GAAP, would not be considered non-GAAP if there are no comparable GAAP measures. Registrants should make clear the purpose of the measures and how they are calculated.

iv. **Individually Tailored Accounting Principles:** The Staff explained that companies should not present non-GAAP measures that use individually tailored accounting principles. Two examples of inappropriate accounting are: 1) Removing acquisition-related accounting and including the historical results of the acquired company prior to the acquisition date and 2) Adjusting and removing the negative book value of a consolidated subsidiary from a book value per share measure.

v. **Catastrophe (CAT) Losses**: The Staff indicated that non-GAAP earnings measures should generally not be adjusted to exclude insurance CAT losses, as consistent with the underlying business of providing insurance coverage CAT losses are typically normal, recurring cash operating expenses. The Staff acknowledged that their comment was not aimed at the practice of separately quantifying and analyzing CAT losses when explaining earning trends, such as in Management's Discussion and Analysis.

vi. **New Non-GAAP Measures**: The Staff suggested that companies talk to them in advance about new non-GAAP measures particularly when adopting new accounting standards.

c. **Investments:**

i. Equity Method Investments – The Staff explained that disclosures should include an explanation of how management made the judgment that an other-than-temporary impairment is not needed when the carrying value of an equity method investment is greater than its fair value.

Comment Process – The Staff reiterated that comments are an invitation to dialogue and not necessarily a request to revise disclosure. The Staff also requested that during the comment process it is helpful for companies to explain if something commented on is not material early in the comment process.

2. **FASB ASU 2018-12: Targeted Improvements to Long-Duration Contracts:**

a. **Education Session**: The Expert Panel provided the Staff with a brief education session of the accounting changes to long-duration contracts under FASB ASU 2018-12.

b. **Shadow Accounting**: The Expert Panel provided the Staff with an update on the changes to shadow accounting as a result of FASB ASU 2018-12. The Staff acknowledged the change in accounting, but indicated no immediate plans to update the SEC Staff Announcement that is codified in FASB ASC 320-10-S99-2

c. **Adoption**: The Expert Panel continued discussion with the Staff of the potential challenges to registrants adopting FASB ASU 2018-12 related to:

i. The SEC 5 Year Table (SEC Regulation S-K, Item 301, "Selected Financial Data.") Issue of whether the registrant would be required to apply ASU 2018-12 to years preceding what is presented in the registrant's primary financial statements in the year of adoption.

The Staff referred to the discussion at the Center for Audit Quality (CAQ) SEC Regulations Committee meeting on September 24, 2019, and reiterated that registrants should, in applying S-

K Item 301, use judgment in determining whether to recast the selected financial data for the adoption of ASU 2018-12 or whether explanatory disclosures would sufficiently explain the lack of comparability between periods. Per the CAQ SEC Regulations Committee meeting minutes:

D. Recast Selected Financial Data for a Retrospective Accounting Change

The Committee members asked the staff how the recent removal of the guidance in FRM 1610 impacts the historical position of the need to recast years 4 and 5 in the selected financial data table upon a retrospective accounting change, other than the adoption of ASC 606. Prior to its deletion, FRM 1610.1 stated "The staff generally expects all periods presented in selected financial data to be presented on a basis consistent with the annual financial statements." In the meeting, the staff recommended that registrants look to the provisions of Item 301 of Regulation S-K, which may require exercising judgment in determining whether years 4 and 5 of the selected financial data table should be recast or whether additional explanatory disclosures would be sufficient to explain factors that materially affect the comparability of information reflected in the selected financial data.

The CAQ SEC Regulations Committee meeting minutes can be found at: https://www.thecaq.org/wp-content/uploads/2020/01/secregulationscommitteehighlights_sep_24_2019_joint.pdf

ii. Date of initial application – Issue of whether the requirements in Item 11(b)(ii) of Form S-3 would require that a registrant adopting ASU 2018-12 to change the date of initial application to the earliest comparative period presented when the registration statement is filed prior to the filing of the Form 10-K in the year of adoption.

For example, a calendar year-end registrant adopts the ASU in the first quarter of 2022, with a transition date of January 1, 2020. In May 2022, the registrant files its first quarter 10-Q reflecting the adoption of the ASU. In June 2022, the registrant files a registration statement on Form S-3 that includes financial statements for the years ending December 31, 2021, 2020, and 2019, as well as the quarters ending March 31, 2022 and 2021. Does the reissuance of the registrant's financial statements change the date of initial application to January 1, 2019 because it is the beginning of the earliest comparative period presented?

The Staff indicated that they would consider the information provided in deciding whether to provide further guidance

3. **FASB ASU 2016-13: Financial Instruments—Measurement of Credit Losses on Financial Instruments:** The Expert Panel provided the Staff with an overview of the insurance specific FASB ASU 2016-12 implementation issues that are currently out for informal comment:
   a. Issue #34: Considerations Related to ASC Topic 326: Financial Instruments - Credit Losses, for Reinsurance Recoverables
   b. Issue #44: Considerations Related to ASC Topic 326: Financial Instruments - Credit Losses, for Premiums Receivable