AN ALERT FROM THE BDO INSURANCE INDUSTRY PRACTICE

BDO KNOWS: INSURANCE

FASB IMPROVES ACCOUNTING FOR LONG-DURATION CONTRACTS

By Imran Makda

The FASB issued ASU 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, to improve, simplify and enhance the financial reporting of long-duration contracts issued by insurance companies.

The effective date for public companies is for fiscal years beginning after December 15, 2020. For all other companies, the ASU is effective for fiscal years beginning after December 15, 2021. Early adoption is permitted. The full accounting update is available here.

BACKGROUND

The FASB issued ASU 2018-12 with the objective of making targeted improvements to the existing recognition, measurement, presentation and disclosure requirements for long-duration contracts issued by an insurance entity. The changes apply to insurance companies that issue long-duration contracts such as life insurance, disability income, long-term care and annuities. The changes do not apply to policyholders or noninsurance companies.

ABOUT BDO'S INSURANCE PRACTICE

BDO's Insurance practice understands the complexities of the industry and the implications for your business. Whether you're looking to tap our extensive SEC experience in order to enter the public market, discuss the latest insurance accounting and reporting requirements from the NAIC, or comply with state regulatory agencies, BDO's Insurance practice provides proactive guidance to our clients. We know that no two insurers are alike, and we tailor our services accordingly. We're proud of our industry focus and experience, and our commitment to delivering the right team with relevant industry experience, both as we begin our relationship and for the long term.

Read more

MAIN PROVISIONS

AREA	PRIOR TO ASU 2018-12	TARGETED IMPROVEMENTS
Liability for Future Policy Benefits	Original assumptions used to measure the liability for future policy benefits are locked at contract inception and held constant over the term of the contract. The liability includes a provision for risk of adverse deviation, and assumptions are unlocked if a premium deficiency arises. An unobservable discount rate (a rate based on an insurance entity's expected yield on its invested assets) is used to discount future cash flows.	The liability for future policy benefits for nonparticipating traditional and limited-payment contracts will be required to be updated for changes in assumptions. Cash flow assumptions will be reviewed and updated as necessary, at least annually, with changes reflected separately in net income. Discount rate assumptions will be updated each reporting period with changes reflected in other comprehensive income. The liability will be discounted at an upper-medium grade (low-credit-risk) fixed-income instrument yield that reflects the characteristics of the liability rather than the invested assets.
Measurement of Market Risk Benefits	Certain market-based options or guarantees associated with deposit (or account balance) contracts share common risk characteristics that expose an insurance entity to capital market risk. However, there are two different measurement models (a fair value model and an insurance accrual model).	Market risk benefits will be measured using a single measurement model (fair value), with the effect of changes in the insurance entity's credit risk recognized in other comprehensive income.
Deferred Acquisition Costs (DACs)	Multiple amortization methods exist, some of which are complex and require numerous inputs and assumptions.	DACs will be amortized on a constant-level basis over the expected term of the contract. DACs will be written off for unexpected contract terminations but will not be subject to an impairment test.
Disclosures	There are limited requirements to disclose information about long-duration contracts.	Several new disclosures will be required, including liability rollforwards and information about significant inputs, judgments, assumptions and methods used in measurement, and the effect of those changes on measurement.

EFFECTIVE DATE AND TRANSITION

The amendments in the ASU are effective for public business entities for fiscal years beginning after December 15, 2020, including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. Early adoption is permitted.

Changes to the liability for future policy benefits and DACs will apply to all outstanding contracts based on their existing carrying amounts at the beginning of the earliest period presented, subject to certain adjustments. An insurance entity will have the option to apply the changes retrospectively using actual historical experience information as of contract inception. This option will be elected at the contract issue-year level and applied to all contract groups for that issue year and all subsequent issue years. Market risk benefits will be measured at fair value at the beginning of the earliest period presented, with the cumulative effect of the changes in the insurance entity's credit risk recognized in accumulated other comprehensive income, while the difference between fair value and carrying value (excluding the effect of credit risk changes) will be recognized in the opening balance of retained earnings.

For more information on how the FASB's new ASU 2018-12 will impact your business, contact Imran Makda at imakda@bdo.com.

HOW DO I GET MORE INFORMATION?

For more information, please contact:

CHRIS BARD
Partner and Specialized Tax Services R&D Practice Leader
310-557-7525 / cbard@bdo.com

ERIC BASE
Audit Partner / Dallas
214-665-0627 / ebase@bdo.com

DOUG BEKKER
Tax Partner / Grand Rapids
616-776-3685 / dbekker@bdo.com

ANTHONY DEMEO
Assurance Partner and Insurance Practice Leader / Fort Lauderdale
954-626-2910 / ademeo@bdo.com

PHIL FORRET
Assurance Partner / Dallas
214-665-0769 / pforret@bdo.com

CARLA FREEMAN
Assurance Partner / Los Angeles
310-557-8247 / cfreeman@bdo.com

TIMOTHY KOVEL
Sr. Tax Director / New York
631-927-1005 / tkovel@bdo.com

IMRAN MAKDA
Assurance Partner and Insurance Practice Leader / New York
212-885-8461 / imakda@bdo.com

PETER POPO
Assurance Partner / Atlanta
404-979-7258 / ppopo@bdo.com

MARC ROCKOWER
Tax Managing Director, Core Tax Services / Woodbridge
212-404-5587 / mrockower@bdo.com

ABOUT BDO USA

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, and advisory services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through more than 60 offices and over 650 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multi-national clients through a global network of more than 73,800 people working out of 1,500 offices across 162 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information please visit: www.bdo.com.

People who know Insurance, know BDO.