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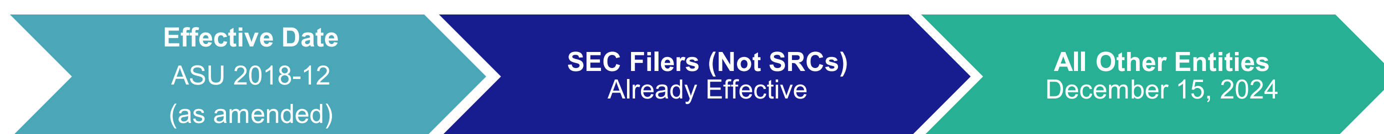
Prepared for the Changes to Long-Duration Insurance Contracts?

The effective date for one of FASB's longest projects is around the corner for smaller reporting companies and nonpublic insurance companies. Accounting Standards Update (ASU) 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, makes targeted—but significant—changes to assumption updates, amortization of deferred acquisition costs (DAC), and accounting for market-risk benefits and adds extensive new disclosures. These amendments will significantly change current practice, and insurers will need to change how they monitor and gather data. In addition, due to the unlocking of assumptions, income statement volatility will increase. Comparability between insurers will increase due to the elimination of certain measurement models and new disclosure requirements. The effect on each insurer will depend on product mix, current accounting practice, and reporting requirements.



Insurers that only issue statutory-basis financials will not be affected by the new rules.

I. Scope

The scope of the amendments is generally unchanged from current GAAP. The ASU applies to all insurance entities that issue long-duration contracts, both insurers and reinsurers, including the following contracts:

- Universal life-type contracts – Terms are not fixed and guaranteed
- Limited-payment contracts – Includes both limited-payment participating and nonguaranteed-premium contracts that are not, in substance, universal life-type contracts
- Certain participating life insurance[1] contracts
- Whole-life contracts
- Term-life contracts

[1] *Participating life insurance contracts that have both of the following characteristics:*

1. They are long-duration participating contracts expected to pay dividends to policyholders based on the actual experience of the insurance entity.

2. Annual policyholder dividends are paid in a manner that both:

  a. Identifies divisible surplus

  b. Distributes that surplus in approximately the same proportion as the contracts are considered to have contributed to divisible surplus

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Consistent with current guidance, the scope includes contracts with characteristics significant to the above products, *i.e.*, universal disability contracts that have many of the same characteristics as universal life-type contracts—with the exception of providing disability benefits instead of life insurance benefits—would be accounted for in a similar manner to universal life-type contracts.

In addition, certain contracts or features also are covered, including:

1. Contracts offered through an insurer's separate accounts
2. Variable annuities with a guaranteed minimum death benefit (GMDB), accumulation benefit (GMAB), or income benefit (GMIB)
3. Contracts providing multiple account balances
4. Contracts with sales inducements

The amendments do not apply to holders of long-duration contracts or noninsurance entities.

II. Assumption Updates

The liability for future policy benefits represents the present value of future benefits to be paid to policyholders and certain related expenses less the present value of future net premiums receivable. Under current guidance, assumptions for measuring future policy benefit liabilities—investment return, mortality, morbidity, lapses, and expense assumptions—are locked in at policy inception and unlocked or reset only if there is a premium deficiency. This may lead to significant differences between initial and current assumption estimates.

ASU 2018-12 mandates an annual review and, if changes exist, update of all assumptions used to calculate the liability for future policy benefits. The updates would be done at the same time every year, or more frequently if actual experience or other evidence indicates earlier assumptions should be revised. In a change from current practice, contracts from different issue years can no longer be grouped. Contracts must be grouped together in quarterly or annual groups. This grouping change will result in a lower level of aggregation for determining contracts in a loss position.

The expenses included in the measurement of the liability for future policy benefits include termination or settlement costs and costs after the premium-paying period. Expense assumptions should not include acquisition costs or any costs required to be expensed when incurred, *e.g.*, general administration, etc. An insurer may make an entitywide election not to update these expenses.

The effect of the change in assumptions on the liability estimate would be recorded in net income; however, separate presentation of that adjustment within the total benefit expense is required so financial statement users can distinguish between liability remeasurements and recurring policyholder benefit expenses. This can be done either parenthetically or as a separate line item. The liability remeasurement gain or loss for traditional and limited-payment contracts may be reported together with the remeasurement gain or loss related to annuitization benefits and death or other insurance benefits.

The ASU provides detailed implementation guidance on the various outcomes of remeasuring the liability for future benefits:

- If after updating the assumptions, the expected benefits and related expenses exceed expected gross premiums, an insurer would:

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    - Set net premiums equal to gross premiums.
    - Increase the estimate of the liability for future policy benefits as of the beginning of the current reporting period.
    - Recognize a corresponding adjustment to net income for the current reporting period.
    - Disclose qualitative and quantitative information related to adverse development.
    - Accrue the liability for future policy benefits with net premiums being set equal to gross premiums, *i.e.*, a ratio of net premiums to gross premiums equal to 100%, until assumptions are subsequently updated.
- If the adjustment related to updating cash flow assumptions is unfavorable but does not result in net premiums exceeding gross premiums, the insurer should:
    - Increase the estimate of the liability for future policy benefits as of the beginning of the current reporting period.
    - Recognize a corresponding change in estimate adjustment to net income for the current reporting period.
    - Accrue the liability for future policy benefits with the revised ratio of net premiums to gross premiums until assumptions are subsequently updated.
- If the adjustment related to updating cash flow assumptions is favorable—including the reversal of previously recognized unfavorable adjustments—the insurance entity should:
    - Decrease the estimate of the liability for future policy benefits as of the beginning of the current reporting period.
    - Recognize a corresponding change in estimate adjustment to net income for the current reporting period.
    - Accrue the liability for future policy benefits with the revised ratio of net premiums to gross premiums until assumptions are subsequently updated.

An insurer is only required to review assumptions annually. It is not required to ***update*** *all assumptions. Some factors, like mortality, morbidity, and lapse rate, are not as volatile as investment returns and may not need to be adjusted every year.*

A. Limited-Payment Contracts

A limited-pay has a set period in which premiums are due, either for a number of years or to a specific age. Once the target year or age is reached, premiums are no longer required, but the policy's benefits last the insured's entire life. Because the collection of premiums does not complete the earning process, gross premiums received in excess of the net premiums must be deferred. For these contracts, an insurer is required to determine changes in the deferred profit liability, contemporaneously with its updating of assumptions for the liability for future benefits and must use the same assumptions for updating both. Cash flow assumptions must be reviewed—and if there is a change, updated—on an annual basis at the same time every year. Cash flow assumptions shall be updated in interim reporting periods if evidence suggests that earlier cash flow assumptions should be revised. The interest accretion rate shall remain the original discount rate used at contract issue date.

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A related charge or credit to net income for the current reporting period as a result of updating cash flow assumptions at the level of aggregation at which reserves are calculated must be determined as follows:

- Cash flow assumptions used to calculate the deferred profit liability at contract issuance shall be updated in subsequent periods using actual historical experience and updated future cash flow assumptions.
- The recalculated deferred profit liability as of the contract issue date shall be subsequently amortized to derive the revised deferred profit liability estimate as of the beginning of the current reporting period.
- The revised deferred profit liability estimate should be compared with the carrying amount of the deferred profit liability as of the beginning of the current reporting period to determine the change in estimate adjustment to be recognized in net income for the current reporting period.

B. Participating Contracts

Participating life insurance contracts are a type of whole-life insurance that pays policyholder dividends. These review and remeasurement requirements do not apply to most participating contracts because they contain both a liability and an equity element (discretionary dividends). However, demutualized insurance companies with closed blocks will have additional disclosures on premium deficiency.

The changes about updating assumptions only apply to traditional and certain participating life insurance contracts that currently follow a “locked-in” accounting model. Regular updates are already required for nontraditional contracts, including universal life and variable annuities.

C. Discount Rate Update

Discount rate assumptions would be updated quarterly. The net premium ratio is not updated for discount rate changes; rather, the effect of discount rate assumption changes is recorded immediately in other comprehensive income (OCI). The interest accretion rate shall remain the original discount rate used at contract issue date.

These changes will result in a more current measure of the liability based on the current assumptions. The effects of any deterioration would be recorded earlier than under current guidance.

Insurers currently use an asset rate or investment yield reflecting the interest rate they expect to earn on the investment assets supporting the insurance policies at contract origination. Under ASU 2018-12, long-duration insurance contract liabilities should be discounted using an upper-medium grade (low credit risk) fixed-income instrument yield, which generally is interpreted as an A rating. Entities should maximize the use of current observable market prices for instruments with duration similar to the liability for future policy benefits. An insurer should not substitute its own estimate for observable market date unless the market reflects transactions that are not orderly. In determining points on the yield curve for which there are limited or no observable market dates, an insurer should use an estimate consistent with existing guidance on fair value measurement in ASC 820, particularly for Level 3 fair value measurement.

Separating the rate used to discount an insurer’s net liability from its investment experience will allow for better comparability across companies. Under previous guidance, an insurer with a lower quality investment portfolio would have reported a lower liability than an insurance entity with a higher quality investment portfolio.

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Discount Rate	
Current	**ASU 2018-12**
Asset rate or investment yield reflecting the interest rate it expects to earn on the assets supporting the policies at contract origination	Upper-medium grade (low credit-risk) fixed-income instrument yield

D. Premium Deficiency & Loss Recognition

Existing guidance requires liability for future policy benefits to include a provision for any adverse deviations from the assumptions locked in at contract inception. Insurers perform a premium deficiency test to determine whether the liability calculated using the original assumptions remains sufficient. Because the assumptions will be assessed annually, the premium deficiency test is no longer required. The premium deficiency test is being replaced with a net premium ratio cap of 100%, *i.e.*, the ratio of total expected benefits and related expenses to total expected premiums, which excludes acquisition costs. If the present value of future benefits and expenses exceeds the present value of future gross premiums, an insurance entity shall:

- Set net premiums equal to gross premiums.
- Increase the liability for future policy benefits.
- Recognize a corresponding charge to net income for the current reporting period.

Contracts from different issue years will no longer be permitted to be grouped, effectively resulting in a lower level of aggregation for determining contracts in a loss position.

III. Market Risk Benefits (MRBs)

A. Scope

An MRB protects a contract holder from capital market risk, *i.e.*, investment losses due to a market correction, and is embedded in nontraditional contracts, mostly variable annuities. MRBs can be found in general account products as well as separate account products. These amendments align the accounting treatment for MRBs. In evaluating whether a contract or contract feature meets the MRB criteria, an insurer should consider that:

- Protection refers to the transfer of a loss in—or shortfall of—the contract holder's account balance from the contract holder to the insurer, with such transfer exposing the insurer to capital market risk that otherwise would have been borne by the contract holder (or beneficiary).
- Protection does not include the death benefit component of a life insurance contract. This condition does not apply to an investment or annuity contract (including an annuity contract classified as an insurance contract).
- A nominal risk is a risk of insignificant amount or a risk that has a remote probability of occurring. An MRB is presumed to expose the insurance entity to other-than-nominal capital market risk if the benefit would vary more than an insignificant amount in response to capital market volatility.

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The second criterion is intended to scope out traditional universal-life and variable-life products but to scope in annuity features where there is current accounting diversity. Features that meet the MRB criteria include GMDBs, GMIBs, GMABs, and guaranteed minimum withdrawal benefits (GMWBs). GMIBs are currently accounted for under a model that spreads changes in cash flow estimates over the life of the contract. GMWBs and GMABs are currently accounted for as derivatives. MRBs for guaranteed minimum lifetime withdrawal benefits will now be accounted for under Accounting Standards Codification (ASC) 944, and insurers will no longer have to first evaluate whether that benefit is a derivative under ASC 815, *Derivatives and Hedging*.

These amendments do not apply to features that are accounted for as embedded derivatives under ASC 815. An insurer should consider the following:

- If a nonoption valuation approach is used, the MRB terms shall be determined in a manner that results in its fair value generally being equal to zero at the contract's inception.
- If an option-based valuation approach is used, the MRB terms shall not be adjusted to result in the MRB being equal to zero at the contract's inception.
- If a contract contains multiple MRBs, those benefits must be bundled together as a single compound MRB.

In general, an equity index feature represents a periodic crediting rate mechanism that affects the amounts credited to the contract holder's account balance, rather than representing a benefit in addition to the account balance that protects the contract holder from and exposes the insurance entity to other-than-nominal capital market risk. Periodic crediting rate mechanisms are required to be evaluated for possible bifurcation under Topic 815. However, an equity-indexed annuity also may contain one or more MRBs.

See examples provided by FASB in Appendix A.

B. Measurement & Presentation

Today, insurers use two different models to value MRBs—some are fair valued and some follow an insurance model where the liability is gradually built up over time. To create consistency, this ASU requires that insurers only use the fair value model. Changes in MRB fair values will be recognized separately in net income; however, fair value changes attributable to a change in the instrument-specific credit risk of MRBs in a liability position will be recognized in OCI. An MRB may be positive (an asset) or negative (a liability) and must be presented separately in the statement of financial position.

Recognizing the fair value of benefit features that are currently measured using the benefit ratio approach would be a significant change in practice and likely will increase earnings volatility.

C. Derecognition

Upon an MRB's derecognition, an insurer will remove any related balance in accumulated OCI. Net income should only reflect a gain or loss realized as a result of the insurer's nonperformance, *e.g.*, the settlement or extinguishment of an obligation for an amount less than the contractual obligation amount. On the annuitization date or extinguishment of the account balance (for withdrawal benefits) the MRB balance shall be derecognized, and the amount deducted (after derecognition of any related amount included in accumulated OCI) shall be used to calculate the liability for future policy benefits for the payout annuity.

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IV. DAC

An insurer incurs many expenses in its underwriting process. Those that directly relate to the successful acquisition of new or renewal insurance contracts are required to be capitalized and recorded as a DAC asset. Capitalizable costs include agent or broker commissions and bonuses, premium taxes, medical and inspection fees, and other costs of policy issuance and underwriting. Consistent with existing guidance, the amendments do not define the costs to be included in acquisition costs but do describe those that are not eligible to be capitalized. Costs related to investments, general administration, policy maintenance costs, product development, market research, and general overhead must be expensed as incurred.

In a big change from current practice, expected acquisition costs, e.g., *expected renewal commissions, will no longer be considered in amortization expense from contract inception, but rather will be amortized only as incurred.*

Amortization – Constant-Level Basis

Acquisition costs are the same across product types; however, the income statement expense varies by product type, as noted in the table below. ASU 2018-12 standardizes the expense pattern, which will no longer fluctuate with an insurance company's investments or underwriting performance.

ASU 2018-12 eliminates the three current methods for amortizing DAC for long-duration contracts and requires insurers to use a constant-level basis method whereby costs would be expensed evenly over the expected term. This can be done on an individual or grouped contract basis. An insurer must group contracts consistent with the grouping used in estimating the liability for future policy benefits. No interest shall accrue to the DAC unamortized balance.

Amortization of DAC		
Product	**Current Method**	**ASU 2018-12**
Traditional Life	Proportion to Premium	Constant-Level Basis
Nontraditional Life	Estimated Gross Profit	
Participating Life	Estimated Gross Margin	

DAC is required to be written off for unexpected contract terminations but is not subject to impairment testing.

Scope – Constant-Level Basis Amortization

FASB has not made any specific changes to amortization guidance related to other balances that insurers can—but are not required to—amortize on a basis consistent with DAC. Examples of these other balances include contract intangible assets and liabilities acquired in a business combination and the net cost of reinsurance.

Sales Inducements

Sales inducements are broadly defined as enhanced returns offered with both fixed and variable products. Due to competition, many insurers offer special product upgrades to their policyholders to retain the relationship. These sales inducements fall into three main buckets:

- Day one bonus – An amount is immediately credited to an account holder's balance.

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- Persistency bonus – An amount will be credited either at the end of a certain period or ratably over some period.
- Enhanced interest rate – In addition to the agreed-upon crediting rate, a policyholder receives a bonus interest rate for some initial period.

Although these costs are incurred to entice and retain customers, they are not considered DAC because they represent amounts owed to contract holders—they represent a benefit cost and not an acquisition cost. Consistent with current guidance, capitalized sales inducements will follow the same amortization model as DAC, noted above. No interest shall accrue to the unamortized balance of deferred sales inducements.

Investment Contracts

The constant-level basis method also should be applied for capitalized costs related to investment contracts that include significant surrender charges or that yield significant revenue from sources other than the investment of the contract holder's funds. For all other investment contracts, an insurer will continue to use the effective interest method to amortize capitalized costs.

Internal Replacements

It is common for a policyholder to replace its policy with a new one—to obtain more or less coverage, to lower the premium payment, or for a policy better suited to its needs. If the replacement contract is substantially unchanged, the unamortized DAC at the time of replacement will remain unchanged. If this is not reasonably practicable, an insurer may determine future amortization on a prospective basis. An entity would allocate the unamortized DAC before the internal replacement between replaced contracts and contracts remaining in the original book of business on a reasonable and systematic basis.

V. Disclosure

Extensive new interim and annual disclosures are required to enable financial statement users to understand the amount, timing, and uncertainty of cash flows arising from insurance contracts. These include disaggregated rollforwards of beginning to ending balances of the liability for future policy benefits, policyholder account balances, MRBs, separate account liabilities, and DAC. Insurers also must disclose information about significant inputs, judgments, assumptions, and methods used in measurement, including changes in those inputs, judgments, and assumptions and the effect of those changes on measurement. Insurers will need to consider the level of aggregation—the level of detail should be appropriate so as not to obscure information with too much insignificant detail or by aggregating too many items with significantly different characteristics. Examples of categories for disaggregation that might be appropriate include any of the following:

- Type of coverage, *e.g.*, major product line
- Geography, *e.g.*, country or region
- Market or type of customer, *e.g.*, individual or group lines of business

The below disclosures are required for both interim and annual reporting periods.

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A. Liability for Future Policy Benefits

The liability for future policy benefits includes liabilities related to traditional, limited-payment, and participating life insurance contracts calculated under a net premium reserving model. In addition, the liability for future policy benefits includes the additional liability related to nontraditional contracts calculated on the basis of a benefit ratio. An insurance entity should disclose the following:

- Disaggregated tabular rollforward of the opening balance to the closing balance with separate presentation of expected future net premiums and expected future benefits. This could include issuances, interest accrual, net premiums or assessments collected, benefit payments, derecognition (lapses or withdrawals), effect of actual variances from expected experience, effect of changes in cash flow assumptions, and effect of changes in discount rate assumptions
- For each disaggregated rollforward presented:
    - The undiscounted ending balance for both the expected future net premiums and expected future benefits
    - Actual experience during the period for mortality, morbidity, and lapses, compared with what was expected for the period
    - Amount of revenue and interest recognized in the statement of operations
    - The amount of any related reinsurance recoverable
    - The amount of gross premiums collected
    - Weighted-average interest rate, a description of the techniques used to determine the interest rate assumption, and information about any adjustments to observable market information
- A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount of the liability, total interest recorded for the period, and total gross premiums collected during the period
- Qualitative and quantitative information about adverse development resulting in an immediate change to current period net income because of net premiums exceeding gross premiums (traditional and limited-pay contracts only)
- Significant inputs, judgments, assumptions, and methods used in the measurement of the liability for future policy benefits, as well as any changes in those items and the effect of those changes on the liability's measurement

See a sample disclosure provided by FASB in Appendix B.

B. Policyholder Account Balances

The policyholder account balance liability represents the contract value that has accrued to the benefit of a policyholder on a nontraditional contract. The account balance is carried at accumulated value (policyholder deposits, plus credited interest, less fees, and withdrawals). This disclosure should exclude separate account balances:

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- Disaggregated tabular rollforward of the opening balance to the closing balance. This might include issuances, premiums received, policy charges, surrenders and withdrawals, benefit payments, transfers from or to separate accounts, and interest credited
- For each disaggregated rollforward presented:
    - The weighted-average crediting rate
    - Net amount at risk – The guaranteed benefit amounts in excess of the current account balance
    - Cash surrender value
- A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount of the liability
- Tabular presentation of policyholders' account balances by range of guaranteed minimum crediting rates, and the related range of the difference between rates being credited to policyholders and the respective guaranteed minimums

See a sample disclosure provided by FASB in Appendix C.

C. MRBs

The following disclosures are required for MRBs:

- A year-to-date disaggregated tabular rollforward of the opening balance to the closing balance, disaggregated by type of market risk benefit. This may include issuances, interest accrual, attributed fees collected, and benefit payments. It also could include the effects of changes in interest rates, equity markets, equity index volatility, future expected policyholder behavior, future expected assumption, or instrument-specific credit risk. It also may include actual policyholder behavior different from expected behavior
- For each disaggregated rollforward presented, the related net amount at risk and weighted-average attained age of contract holders
- A reconciliation of the disaggregated rollforward to the aggregate ending carrying amount in the statement of financial postion, disaggregated between MRBs that are assets and liabilities
- Significant methods, inputs, assumptions, and judgments used in MRB measurement, any changes in those items, and the effect of those changes on the MRB measurement

See a sample disclosure provided by FASB in Appendix D.

D. DAC

An insurer must disclose the following information on DAC and sales inducements:

- The nature of the costs deferred
- Information about the inputs, judgments, assumptions, and methods used to determine amortization amounts and changes in those inputs, judgments, and assumptions

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- A year-to-date disaggregated tabular rollforward of the beginning to the ending balance of unamortized DAC—including any balances amortized on a basis consistent with DAC
- A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount in the statement of financial position

See an example provided by FASB in Appendix E.

E. Separate Account Liabilities

A separate account is a segregated accounting and reporting account held by an insurance company not in, but "separate," from its general account. A separate account allows investors to choose an investment category according to their individual risk tolerance and desire for performance. An insurer must disclose:

- Disaggregated tabular rollforward of the opening balance to the closing balance
- For each rollforward presented, the related cash surrender values
- A reconciliation of the rollfowards to the aggregate ending carrying amount of the liability

See an example provided by FASB in Appendix F.

V. Transition

Due to the long-dated nature of these insurance contracts, FASB provided limited flexibility in adopting these amendments.

A. Liability for Future Policyholder Benefits

An insurer can choose between two transition approaches for the liability for future policy benefits.

Modified Retrospective

Under the modified approach, for contracts in force at the transition date, an insurer would continue to use the existing locked-in investment yield to calculate the net premium ratio, rather than the upper-medium-grade, fixed-income corporate yield rate. FASB provided the following guidance:

- The present value of future benefits and related expenses less the transition date carrying amount shall be compared with the present value of future gross premiums to calculate the ratio of net premiums to gross premiums.
- An insurance entity shall adjust the opening balance of retained earnings only to the extent that net premiums exceed gross premiums.
- An insurance entity shall compare the liability for the future policy benefits balance using the existing locked-in discount rate and the new discount rate as of the transition date. Any resulting difference in the liability for the future policy benefits balance shall be recorded to opening accumulated OCI.

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- The transition date shall be considered the revised contract issue date for purposes of subsequent adjustments but not to group contracts.
- For contracts in force issued before the transition date, an insurer is prohibited from grouping contracts together from different original contract issue years. Contracts should be grouped into quarterly or annual groups based on the original contract issue date to calculate the liability for future policy benefits. For acquired contracts, the acquisition date shall be considered the original contract issue date.

Full Retrospective

An entity has the option of applying the amendments on a full retrospective basis. An entity would adjust opening retained earnings with a cumulative catch-up adjustment using actual historical experience as of contract inception.

For consistency:

- An insurance entity shall apply the same transition method to both the liability for future policy benefits and DAC (and balances amortized on a basis consistent with DAC).
- The retrospective election shall be made at the same contract issue-year level for both the liability for future policy benefits and DAC for that contract issue year and all subsequent contract issue years on an entitywide basis, *i.e.*, applied to all contracts and product types.
- For contracts issued or acquired before the earliest issue-year level elected for retrospective application, an insurer could use the modified approach noted above.

Under this election, an entity may not substitute an estimate of historical experience for actual historical experience.

FASB provided additional transition guidance if this option is elected:

- Recalculate the net premiums as of the contract issue date by considering actual historical experience and updated future cash flow assumptions, discounted using the new discount rate, *i.e.*, an A rating, at the contract issue date. That new discount rate represents the interest accretion rate to be used over the contract's life.
- Use the revised net premiums to measure the liability for future policy benefits as of the transition date.
- Record a cumulative catch-up adjustment to opening retained earnings as of the transition date equal to the difference between the carrying value of the liability for future policy benefits (adjusted for the removal of any related amounts in accumulated OCI) and the liability for the future policy benefits balance calculated using the updated net premiums.
- At the transition date, an insurance entity shall compare the liability for the future policy benefits balance using the interest accretion rate and the current discount rate, *i.e.*, an A rating, at the transition date. Differences in the liability for the future policy benefits balance shall be recorded to accumulated OCI.

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B. MRBs

A retrospective approach is required for MRBs. At transition, MRBs should be measured at fair value at the beginning of the earliest period presented in the financial statements. An insurer should maximize the use of relevant observable information as of contract inception and minimize the use of unobservable information in determining the MRB balance at the beginning of the earliest period presented. If prior period assumptions are unobservable or otherwise unavailable and cannot be independently substantiated, the insurance entity may use hindsight in determining those assumptions.

The cumulative effect of changes in an entity's own credit risk between contract inception date and transition date should be recognized in accumulated OCI. The difference between fair value and carrying value at transition—excluding the effect of the insurer's own credit risk—should be adjusted to opening retained earnings.

C. DAC

The transition approach for DAC must be consistent with the transition applied to the liability for future policyholder benefits.

D. Transition Disclosures

In the year of adoption, an insurer must disclose the following information about the liability for future policy benefits and DAC (and balances amortized on a basis consistent with DAC):

- A disaggregated tabular rollforward of the ending balance of the reporting period before the transition date to the opening balance at the beginning of the earliest period presented. If retrospective basis was elected, the insurer shall further disaggregate the rollforward between the effects of the retrospective application and the modified retrospective application
- Qualitative and quantitative information about transition adjustments related to:
    - The opening balance of retained earnings
    - Accumulated OCI
    - Net premiums exceeding gross premiums
    - The establishment of a premium deficiency

An insurance entity shall disclose the following information about MRBs:

- A disaggregated tabular rollforward of the ending balance of the reporting period before the transition date to the opening balance at the beginning of the earliest period presented
- Qualitative and quantitative information about transition adjustments related to the opening balance of retained earnings and accumulated OCI

Conclusion

These changes are the biggest change to GAAP accounting for long-duration insurers since the introduction of FAS 60 in the early 1980s. The principle-based nature of the new guidance means there is a lot to consider and even more to do to ensure requirements are implemented on time and budget.

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Appendix A – Examples – MRBs

GMAB or GMDB

A contract holder deposits $100,000 in a deferred annuity (either fixed or variable) that provides for a GMAB that guarantees that at a specified anniversary date, *e.g.*, five years, the contract holder's account balance will be the greater of the following:

- The account value
- Deposits less partial withdrawals accumulated at 3% interest compounded annually

The contract holder's account balance is exposed to stock market performance. At the specified anniversary date, the contract holder's account balance has declined to $80,000 due to stock market declines. The guaranteed minimum value of the $100,000 deposit compounded annually at 3% interest is $115,930. The contract holder's account balance will be increased to the greater amount, resulting in an account balance of $115,930. In this example, the GMAB benefit meets the MRB criteria because the GMAB protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk. Specifically, the insurance entity compensates the contract holder for the shortfall (due to stock market declines) between the account balance amount of $80,000 and the guaranteed amount of $115,930. The GMAB should be measured at fair value. Similarly, if on the date of the contract holder's death the deferred annuity provides a GMDB amount of $115,930 while the account balance is $80,000, the GMDB meets the MRB criteria because the insurance entity provides compensation for the shortfall (due to stock market declines) between the account balance amount of $80,000 and the guaranteed amount of $115,930.

Guaranteed Minimum Living Benefits

A contract holder deposits $100,000 in a deferred annuity (either fixed or variable) that provides a GMIB. The contract specifies that if the contract holder elects to annuitize, the amount available to annuitize will be the higher of the account balance or the sum of deposits less withdrawals. The contract holder's account balance is exposed to stock market performance. At the date that the contract holder chooses to annuitize, the account balance has declined to $80,000 due to stock market declines.

In this example, the GMIB meets the criteria for an MRB benefit because the GMIB protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk. Specifically, the insurance entity compensates the contract holder for the shortfall (due to stock market declines) between the account balance amount of $80,000 and the $100,000 guaranteed amount at the annuitization date. During the accumulation phase, the GMIB feature should be measured at fair value. Similarly, if the deferred annuity provides a GMWB or a guaranteed minimum lifetime withdrawal benefit that protects the contract holder from other-than-nominal capital market risk and exposes the insurance entity to other-than-nominal capital market risk, the GMWB, or the guaranteed minimum lifetime withdrawal benefit meets the MRB criteria.

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Appendix B – Example – Disclosures for Liability for Future Policy Benefits

This example illustrates the information that an insurance entity with two major long-duration product lines—term life and whole life—should disclose in its 20X2 financial statements to meet certain requirements for the liability for future policy benefits.

Note X: Liability for Future Policy Benefits

The balances of and changes in the liability for future policy benefits follow.

		December 31,			
		20X2		20X1	
		Term Life	Whole Life	Term Life	Whole Life
Present Value of Expected Net Premiums	Balance, beginning of year	$ VVV	$ VVV	$ XXX	$ XXX
	Beginning balance at original discount rate	WWW	WWW	XXX	XXX
	Effect of changes in cash flow assumptions	XXX	XXX	XXX	XXX
	Effect of actual variances from expected experience	XXX	XXX	XXX	XXX
	Adjusted beginning of year balance	XXX	XXX	XXX	XXX
	Issuances	XXX	XXX	XXX	XXX
	Interest accrual	XXX	XXX	XXX	XXX
	Net premiums collected [(a)]	(XXX)	(XXX)	(XXX)	(XXX)
	Derecognition (lapses)	(XXX)	(XXX)	(XXX)	(XXX)
	Ending balance at original discount rate	YYY	YYY	WWW	WWW
	Effect of changes in discount rate assumptions	XXX	XXX	XXX	XXX
	Balance, end of year	$ ZZZ	$ ZZZ	$ VVV	$ VVV
Present Value of Expected Future Policy Benefits	Balance, beginning of year	$ VVV	$ VVV	$ XXX	$ XXX
	Beginning balance at original discount rate	WWW	WWW	XXX	XXX
	Effect of changes in cash flow assumptions	XXX	XXX	XXX	XXX
	Effect of actual variances from expected experience	XXX	XXX	XXX	XXX
	Adjusted beginning of year balance	XXX	XXX	XXX	XXX
	Issuances	XXX	XXX	XXX	XXX
	Interest accrual	XXX	XXX	XXX	XXX
	Benefit payments	(XXX)	(XXX)	(XXX)	(XXX)
	Derecognition (lapses)	(XXX)	(XXX)	(XXX)	(XXX)
	Ending balance at original discount rate	YYY	YYY	WWW	WWW
	Effect of changes in discount rate assumptions	XXX	XXX	XXX	XXX
	Balance, end of year	$ ZZZ	$ ZZZ	$ VVV	$ VVV
	Net liability for future policy benefits	$ CCC	$ DDD	$ AAA	$ BBB
	Less: Reinsurance recoverable	XXX	XXX	XXX	XXX
	Net liability for future policy benefits, after reinsurance recoverable	$ XXX	$ XXX	$ XXX	$ XXX

(a) Net premiums collected represent the portion of gross premiums collected from policyholders that is used to fund expected benefit payments.

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The reconciliation of the net liability for future policy benefits to the liability for future policy benefits in the consolidated statement of financial position follows.

	December 31,			
	20X2		20X1	
Term life	$	CCC	$	AAA
Whole life		DDD		BBB
Other		XXX		XXX
Total	$	XXX	$	XXX

	December 31,			
	20X2		20X1	
Term life				
Expected future benefit payments	$	XXX	$	XXX
Expected future gross premiums	$	XXX	$	XXX
Whole life				
Expected future benefit payments	$	XXX	$	XXX
Expected future gross premiums	$	XXX	$	XXX

The amount of undiscounted expected gross premiums and expected future benefit payments follows.

The amount of revenue and interest recognized in the statement of operations follows.

The weighted-average interest rate follows.

Gross Premiums or Assessments	Interest Expense

	December 31,	
	20X2	20X1
Term life		
Interest accretion rate	XXX%	XXX%
Current discount rate	XXX%	XXX%
Whole life		
Interest accretion rate	XXX%	XXX%
Current discount rate	XXX%	XXX%

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Appendix C – Example – Disclosures for Liability for Policyholders' Account Balances

This example illustrates the information that an insurance entity with two major long-duration products with policyholders' account balances (universal life and fixed annuities) should disclose in its 20X2 financial statements.

Note X: Policyholders' Account Balances

The balance of account values by range of guaranteed minimum crediting rates and the related range of difference, in basis points, between rates being credited to policyholders and the respective guaranteed minimums follow.

	December 31, 20X2					
	Range of Guaranteed Minimum Crediting Rate	At Guaranteed Minimum	1 Basis Point–50 Basis Points Above	51 Basis Points–150 Basis Points Above	Greater Than 150 Basis Points Above	Total
Universal Life	X.XX%–X.XX%	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
	X.XX%–X.XX%	XXX	XXX	XXX	XXX	XXX
	Greater than X.XX%	XXX	XXX	XXX	XXX	XXX
	Total	$ XXX	$ XXX	$ XXX	$ XXX	$ CCC
Fixed Annuity	X.XX%–X.XX%	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
	X.XX%–X.XX%	XXX	XXX	XXX	XXX	XXX
	Greater than X.XX%	XXX	XXX	XXX	XXX	XXX
	Total	$ XXX	$ XXX	$ XXX	$ XXX	$ DDD

	December 31, 20X1					
	Range of Guaranteed Minimum Crediting Rate	At Guaranteed Minimum	1 Basis Point–50 Basis Points Above	51 Basis Points–150 Basis Points Above	Greater Than 150 Basis Points Above	Total
Universal Life	X.XX%–X.XX%	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
	X.XX%–X.XX%	XXX	XXX	XXX	XXX	XXX
	Greater than X.XX%	XXX	XXX	XXX	XXX	XXX
	Total	$ XXX	$ XXX	$ XXX	$ XXX	$ AAA
Fixed Annuity	X.XX%–X.XX%	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
	X.XX%–X.XX%	XXX	XXX	XXX	XXX	XXX
	Greater than X.XX%	XXX	XXX	XXX	XXX	XXX
	Total	$ XXX	$ XXX	$ XXX	$ XXX	$ BBB

The balances of and changes in policyholders' account balances follow.

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	December 31,			
	20X2		20X1	
	Universal Life	Fixed Annuity	Universal Life	Fixed Annuity
Balance, beginning of year	$ AAA	$ BBB	$ XXX	$ XXX
Issuances	XXX	XXX	XXX	XXX
Premiums received	XXX	XXX	XXX	XXX
Policy charges [(a)]	(XXX)	(XXX)	(XXX)	(XXX)
Surrenders and withdrawals	(XXX)	(XXX)	(XXX)	(XXX)
Benefit payments	(XXX)	(XXX)	(XXX)	(XXX)
Net transfers from (to) separate account	XXX	XXX	XXX	XXX
Interest credited	XXX	XXX	XXX	XXX
Other	XXX	XXX	XXX	XXX
Balance, end of year	$ CCC	$ DDD	$ AAA	$ BBB
Weighted-average crediting rate	X.XX%	X.XX%	X.XX%	X.XX%
Net amount at risk [(b)]	$ XXX	$ XXX	$ XXX	$ XXX
Cash surrender value	$ XXX	$ XXX	$ XXX	$ XXX

(a) Contracts included in the policyholder account balances are generally charged a premium and/or monthly assessments on the basis of the account balance.

(b) For those guarantees of benefits that are payable in the event of death, the net amount at risk is generally defined as the current guaranteed minimum death benefit in excess of the current account balance at the balance sheet date.

The reconciliation of policyholders' account balances to the policyholders' account balances' liability in the consolidated statement of financial position follows.

	December 31,	
	20X2	20X1
Universal life	$ CCC	$ AAA
Fixed annuity	DDD	BBB
Other	XXX	XXX
Total	$ XXX	$ XXX

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Appendix D – Example – MRB Disclosures

This example illustrates the information that an insurance entity with MRBs should disclose in its 20X2 financial statements.

Note X: Market Risk Benefits

The balances of and changes in GMWBs associated with variable annuities and indexed annuities follow.

The reconciliation of MRBs by amounts in an asset position and in a liability position to the MRBs amount in the consolidated statement of financial position follows.

	December 31, 20X2		December 31, 20X1	
	Variable Annuities	Indexed Annuities	Variable Annuities	Indexed Annuities
Balance, beginning of year	$ AAA	$ FFF	$ XXX	$ XXX
Balance, beginning of year, before effect of changes in the instrument-specific credit risk	XXX	XXX	XXX	XXX
Issuances	XXX	XXX	XXX	XXX
Interest accrual	XXX	XXX	XXX	XXX
Attributed fees collected	XXX	XXX	XXX	XXX
Benefit payments	(XXX)	(XXX)	(XXX)	(XXX)
Effect of changes in interest rates	XXX	XXX	XXX	XXX
Effect of changes in equity markets	XXX	XXX	XXX	XXX
Effect of changes in equity index volatility	XXX	XXX	XXX	XXX
Actual policyholder behavior different from expected behavior	XXX	XXX	XXX	XXX
Effect of changes in future expected policyholder behavior	XXX	XXX	XXX	XXX
Effect of changes in other future expected assumptions	XXX	XXX	XXX	XXX
Balance, end of year, before effect of changes in the instrument-specific credit risk	XXX	XXX	XXX	XXX
Effect of changes in the instrument-specific credit risk	XXX	XXX	XXX	XXX
Balance, end of year	$ GGG	$ LLL	$ AAA	$ FFF
Reinsurance recoverable, end of year	$ XXX	$ XXX	$ XXX	$ XXX
Balance, end of year, net of reinsurance	$ XXX	$ XXX	$ XXX	$ XXX

	December 31,					
	20X2			20X1		
	Asset	Liability	Net	Asset	Liability	Net
Variable annuities	$ XXX	$ XXX	$ GGG	$ XXX	$ XXX	$ AAA
Indexed annuities	XXX	XXX	LLL	XXX	XXX	FFF
	$ XXX	$ XXX	$ NNN	$ XXX	$ XXX	$ MMM

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Appendix E – Example – DAC Disclosures

Note X: DAC

The balances of and changes in DAC as of and for the years ended December 31, 20X2, and December 31, 20X1, respectively, follow.

	As of December 31, 20X2			
	Whole Life	Universal Life	Variable Universal Life	Total
Balance, beginning of year	$ YYY	$ YYY	$ YYY	$ YYY
Capitalizations	XXX	XXX	XXX	XXX
Amortization expense	(XXX)	(XXX)	(XXX)	(XXX)
Experience adjustment	(XXX)	(XXX)	(XXX)	(XXX)
Balance, end of year	$ ZZZ	$ ZZZ	$ ZZZ	$ ZZZ

	As of December 31, 20X1			
	Whole Life	Universal Life	Variable Universal Life	Total
Balance, beginning of year	$ WWW	$ WWW	$ WWW	$ WWW
Capitalizations	XXX	XXX	XXX	XXX
Amortization expense	(XXX)	(XXX)	(XXX)	(XXX)
Experience adjustment	(XXX)	(XXX)	(XXX)	(XXX)
Balance, end of year	$ YYY	$ YYY	$ YYY	$ YYY

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Appendix F – Example – Information About Separate Account Liabilities

This example illustrates the separate account liability information an insurance entity should disclose.

Note X: Separate Account Liability

The balances of and changes in separate account liabilities follow.

	December 31,			
	20X2		20X1	
	Variable Universal Life	Variable Annuities	Variable Universal Life	Variable Annuities
Balance, beginning of year	$ BBB	$ AAA	$ XXX	$ XXX
Premiums and deposits	XXX	XXX	XXX	XXX
Policy charges	(XXX)	(XXX)	(XXX)	(XXX)
Surrenders and withdrawals	(XXX)	(XXX)	(XXX)	(XXX)
Benefit payments	(XXX)	(XXX)	(XXX)	(XXX)
Investment performance	XXX	XXX	XXX	XXX
Net transfers from (to) general account	XXX	XXX	XXX	XXX
Other charges	(XXX)	(XXX)	(XXX)	(XXX)
Balance, end of year	$ DDD	$ CCC	$ BBB	$ AAA
Cash surrender value [(a)]	$ XXX	$ XXX	$ XXX	$ XXX

(a) Cash surrender value represents the amount of the contract holder's account balances distributable at the balance sheet date less certain surrender charges.

The reconciliation of separate account liabilities to the separate account liability balance in the consolidated statement of financial position follows.

	December 31,	
	20X2	20X1
Variable universal life	$ DDD	$ BBB
Variable annuity	CCC	AAA
Other	XXX	XXX
Total	$ XXX	$ XXX

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