MILLIMAN WHITE PAPER

FASB approves targeted improvements

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The Financial Accounting Standards Board (FASB) has approved the issuance of a final Accounting Standards Update (ASU) of targeted changes to the accounting for long duration insurance contracts. The targeted improvements will be effective in 2021 with early adoption permitted. This paper outlines the decisions and discussions at the June 6, 2018, FASB meeting.

Summary of approved changes

At its June 6 meeting, the FASB approved moving to final balloting on the ASU for targeted improvements for long duration insurance contracts. This is the last step in its due process and means it has effectively approved a final ASU to be issued.

Based on discussion at the meeting the staff is targeting issuance of the final ASU at the end of August 2018. The targeted changes would be effective for reporting periods beginning after December 31, 2020, with earlier adoption permitted.

The FASB made one change to the transition requirements for traditional insurance contracts when applying the modified transition approach. It will set the discount rate for use in determining the reserve change to be shown in income to the rate that is currently used in determining the liability for future policyholder benefits. A current rate consistent with the ASU requirements will be used to determine the reserve to be shown on the balance sheet, with the difference due to discount rates being an adjustment to accumulated other comprehensive income at transition.

The FASB staff presented final wording for the definition of market risk benefits (MRB) that is intended to address its intention to scope in all guaranteed minimum benefits (GMxBs), including Guaranteed Minimum Death Benefits (GMDBs) arising from both variable and fixed annuity contracts. The final ASU will likely include some clarifications and examples to help show which benefit features are in scope and which ones are not.

As part of its decision process for approving the standard FASB members provided their individual views on the cost/benefit analysis of issuing the ASU. While individual members noted that it was likely each of them did not agree with every individual decision that FASB made to arrive at the final ASU, they were unanimous in their views that the changes taken as a whole were going to be beneficial to both users and preparers. Board members noted that in their experience both academic research and the experience of investment managers show that the supply of capital for the insurance industry, and for those companies issuing long duration contracts in particular, is limited relative to other industries. They cited that part of the reason this is the case is that the accounting for long duration insurance contracts is opaque, has multiple measurement models, and lacks the ability to signal when expectations change about experience. Board members believe the ASU will result in better information for users regarding the impact of both favorable and unfavorable changes in expected cash flow assumptions, reducing the measurement models (particularly for market risk benefits) and reducing complexity. As a result of such analysis they believe the ASU will be a marked improvement in the accounting for long duration products and approved it unanimously.

Conclusion

The targeted changes will require substantial implementation resources and transition costs. The approved changes will have a significant impact on the measurement of liabilities, deferred acquisition costs (DAC), and earnings emergence for a large portion of the life insurance and annuity products issued by insurers. With mandatory adoption in 2021, and a requirement to show two years of comparative values, insurers have little time to determine how they will address the impending changes, understand their impacts, and communicate revised earnings expectations to their stakeholders. The effect of many of the changes will depend on the specific circumstances of individual companies. In-depth analysis will need to be undertaken to determine the best path forward for implementing these changes.

CONTACT

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