Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** *ASU 2022-05, Transition for Sold Contracts*

**Check (applicable entity):**

 P/C Life Health

Modification of existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue: This agenda item has been drafted to consider *ASU 2022-05, Transition for Sold Contracts* (ASU) for statutory accounting. The FASB issued the ASU in December 2022 to amend specific sections of *ASU 2018-12, Targeted Improvements for Long-Durations Contracts* (LDTI). The amendments made by the ASU are intended to reduce implementation costs and complexity associated with the adoption of LDTI for contracts that have been derecognized in accordance with the ASU before the LDTI effective date. The revisions captured in the ASU are summarized as follows:

The amendments in the ASU amend the LDTI transition guidance to allow an insurance entity to make an accounting policy election on a transaction-by-transaction basis. An insurance entity may elect to exclude contracts that meet certain criteria from applying the amendments in the LDTI. To qualify for the accounting policy election, as of the LDTI effective date both of the following conditions must be met:

* 1. The insurance contracts must have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities.
	2. The entity has no significant continuing involvement with the derecognized contracts.

ASU 2018-12, as amended by 2022-05, is effective for public entities for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. For nonpublic entities, the LDTI is effective for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. The LDTI includes different transition provisions as follows:

* For the liability for future policyholder benefits and deferred acquisition costs, insurance entities should apply the amendments to contracts in force as of the beginning of the earliest period presented on the basis of their existing carrying amounts, adjusted for the removal of any related amounts in accumulated other comprehensive income. Insurance entities are permitted to apply the amendments retrospectively (with a cumulative catch-up adjustment to the opening balance of retained earnings), using actual historical experience information as of contract inception. (Estimates of historical experience may not be substituted for actual historical experience.) If electing retrospective application, it must be applied entity-wide for the same contract issue year, and all subsequent contract issue years. (Meaning, it must be used to all products and contracts issued in the first year in which retrospective application will be applied, and all subsequent products and contracts issued in later years.)
* For market risk benefits, insurance entities should apply the amendments retrospectively as of the beginning of the earliest year presented. An insurance entity may use hindsight in instances in which assumptions in a prior period are unobservable or otherwise unavailable and cannot be independently substantiated. The difference between fair value and the carrying value at the transition date, excluding the effect of changes in the instrument-specific credit risk, requires an adjustment to the opening balance of retained earnings.

Existing Authoritative Literature:

The key changes reflected in ASU 2018-12 revised U.S. GAAP guidance previously rejected for statutory accounting. (In a couple instances, the prior U.S. GAAP guidance was not reviewed for SAP - as the guidance was not Board Directed, or was still pending SAP review.)

References from Appendix D – Cross-Reference to SAP:

|  |  |
| --- | --- |
| **U.S. GAAP** | **SAP Accounting Provisions** |
| *FAS 60, Accounting and Reporting by Insurance Entities* | Rejected in SSAP No. 40R, SSAP No. 50, SSAP No. 51R, SSAP No. 52, SSAP No. 53, SSAP No. 54R, SSAP No. 57, SSAP No. 59 and SSAP No. 71 |
| *FAS 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments* | Rejected in SSAP No. 50, SSAP No. 51R, SSAP No. 52 and SSAP No. 71  |
| *FSP FAS 97-1, Situations in Which Paragraphs 17(b) and 20 of FAS 97 Permit or Require Accrual of an Unearned Revenue Liability* | Not Board Directed |
| *SOP 95-1, Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises* | Rejected in SSAP No. 51R and SSAP No. 52 |
| *SOP 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts* | Rejected in SSAP No. 56 |
| *SOP 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchange of Insurance Contracts* | Rejected in SSAP No. 71 |
| *SOP 00-3, Accounting by Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Participating Contracts* | Pending SAP  |
| *AICPA Practice Bulletin 8, Application of FAS 97 to Insurance Enterprises* | Rejected in SSAP No. 51R and SSAP No. 52R |
| *ASU 2018-12, Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts* | Rejected in Preamble, SSAP No. 50, SSAP No. 51R, SSAP No. 52, SSAP No. 54R, SSAP No. 55, SSAP No. 56, SSAP No. 71, and SSAP No. 86 |

**Other U.S. GAAP revised as a result of the ASU include:**

* *FAS 133, Accounting for Derivative Instruments and Hedging Activities* (and related DIGs) – The framework of FAS 133 was adopted with modification in *SSAP No. 86—Derivatives*. The revisions from ASU 2018-12 indicate that contracts with market risk benefits do not need to be bifurcated as embedded derivatives, as the guidance in ASU 2018-12 requires market risk benefits to be measured at fair value. The ASU revisions also delete or revise related implementation guidance for assessing whether embedded derivatives shall be bifurcated under U.S. GAAP. **This guidance will not impact the FAS 133 guidance adopted with modification, as SSAP No. 86 specifies that embedded derivatives shall not be separated from the derivative instrument.**
* *FAS 130, Other Comprehensive Income* – FAS 130 was rejected as not applicable under statutory accounting. The revisions from ASU 2018-12 modify FAS 130 to specify the additional components (e.g., changes in discount rate assumptions) that are recognized through OCI. These modifications will not impact the prior statutory accounting decision to reject FAS 130 for statutory accounting.

**The following relevant SAP guidance is noted:**

* ***SSAP No. 51—Life Contracts*:** This SSAP establishes statutory accounting principles for income recognition and policy reserves for life contracts. This SSAP identifies that policy reserves shall be established as required in *Appendix A-820, Minimum Life and Annuity Reserves* and *Appendix A-822, Asset Adequacy Analysis Requirements* or the *Valuation Manual.*
* ***SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses:*** This SSAP establishes statutory accounting principles for recording liabilities for unpaid claims and claim adjustment expenses for life insurance contracts and accident and health contracts. (It also addresses unpaid losses and LAE for property and casualty contracts.) Pursuant to the guidance in paragraph 12, for each line of business, and for all lines of business in the aggregate, management shall record its best estimate of its liabilities for unpaid claims, unpaid losses and loss/claim adjustment expenses. This guidance identifies that management shall follow the concept of conservatism when determining estimates, but there is not a specific requirement to include a provision for adverse deviation in claims.With the revisions reflected in ASU 2018-12, the U.S. GAAP guidance has been revised to specify that the assumptions used in determining a liability for future policy benefits shall not include a provision for the risk of adverse deviation. Prior to these revisions, the guidance in ASC 944-40-30-7 specifically stated that the assumptions shall include a provision for the risk of adverse deviation. *(Note, as detailed in the proposed statutory accounting modifications, reference to the old U.S. GAAP guidance for adverse deviation is included in the Preamble and is proposed to be deleted.)*
* ***SSAP No. 71—Policy Acquisition Costs and Commissions*:** This SSAP establishes statutory accounting principles for policy acquisition costs and commissions. Pursuant to SSAP No. 71, all policy acquisition costs and commissions shall be expensed when incurred. Although the ASU is streamlining the amortization of capitalized deferred acquisition costs, this revision will not impact statutory accounting. *(Note, as detailed in the proposed statutory accounting modifications, reference to the old U.S. GAAP guidance is included in the Preamble and is proposed to be modified to reflect the new guidance.)*

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:** None

**Convergence with International Financial Reporting Standards (IFRS):** In 2008, the FASB undertook an insurance contracts project jointly with the International Accounting Standards Board (IASB). In 2013, after considering comments from the exposure of a 2010 Discussion Draft and a 2013 Proposed Update, the FASB decided to separate from the IASB project, and instead focus on targeted improvements to existing U.S. GAAP concepts. The decision to focus on targeted-improvements to existing U.S. GAAP guidance, with the continued limitation of the guidance to insurance companies, was strongly supported by commenters in lieu of introducing a completely new accounting model that would apply to all entities that issued “insurance contracts.”

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose proposed revisions to reject *ASU 2022-05, Transition for Sold Contracts* as not applicable for statutory accounting in *SSAP No. 50–Classifications of Insurance or Managed Care Contracts; SSAP No. 51R—Life Contracts; SSAP No. 52—Deposit-Type Contracts; SSAP No. 56—Separate Accounts; SSAP No. 71—Policy Acquisition Costs and Commissions* and *SSAP No. 86—Derivatives*. The guidance in ASU 2022-05 provides updated transition guidance for ASU 2018-12, which had previously been rejected for statutory accounting. The proposed revisions are illustrated below:

*SSAP No. 50–Classifications of Insurance or Managed Care Contracts*

46. This statement rejects the U.S. GAAP classifications (i.e., short-duration and long-duration) found in *ASU 2022-05 Transition for Sold Contracts, ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts, FASB Statement No. 60,* *Accounting and Reporting by Insurance Enterprises*, *FASB Statement No. 97,* *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, and *FASB Statement No. 120,* *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long Duration Participating Contracts*.

 *SSAP No. 51R—Life Contracts*

56. This statement rejects *ASU 2022-05 Transition for Sold Contracts, ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts, FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises, FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments, FASB Statement 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts,* AICPA *Practice Bulletin No. 8, Application of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses From the Sale of Investments, to Insurance Enterprises,* the AICPA *Audit and Accounting Guide—Audits of Stock Life Insurance Companies,* AICPA *Statement of Position 95-1, Accounting for Certain Activities of Mutual Life Insurance Enterprises* relating to accounting and reporting for policy reserves for short and long duration contracts, and *FASB Interpretation No. 40, Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises, an interpretation of FASB Statements No. 12, 60, 97, and 113.*

 *SSAP No. 52—Deposit-Type Contracts*

25. This statement rejects *ASU 2022-05 Transition for Sold Contracts, ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, *FASB Statement No. 60,* *Accounting and Reporting by Insurance Enterprises*, *FASB Statement No. 97,* *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, *FASB Statement 120,* *Accounting and Reporting by Mutual Life Insurance* Enterprises *and by Insurance Enterprises for Certain Long-Duration Participating Contracts*,AICPA *Practice Bulletin No. 8, Application of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses From the Sale of Investments, to Insurance Enterprises,* the AICPA *Audit and Accounting Guide—Audits of Stock Life Insurance Companies*, AICPA *Statement of Position 95-1,* *Accounting for Certain Activities of Mutual Life Insurance Enterprises* relating to accounting and reporting for policy reserves for short and long duration contracts, and *FASB Interpretation No. 40, Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises, an interpretation of FASB Statements No. 12, 60, 97, and 113*.

 *SSAP No. 56—Separate Accounts*

41. This statement rejects *ASU 2022-05 Transition for Sold Contracts, ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, AICPA *Statement of Position 03-1, Accounting and Reporting by* InsuranceEnterprises *for Certain Nontraditional Long-Duration Contracts and for Separate Accounts* (SOP 03-1). The disclosure elements included within this SSAP are derived from the criteria for separate account reporting under SOP 03-1; however, this SSAP does not restrict separate account reporting pursuant to the criteria established in SOP 03-1.

*SSAP No. 71—Policy Acquisition Costs and Commissions*

6. This statement rejects *ASU 2022-05 Transition for Sold Contracts, ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, *ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts, FASB Statement No. 60,* *Accounting and Reporting by Insurance Enterprises, FASB Statement No. 97,* *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, and *Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts.*

 *SSAP No. 86—Derivatives*

73. This statement rejects *ASU 2022-05 Transition for Sold Contracts, 2020-06, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40), Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*, *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323 and Topic 815, ASU 2018-03, Recognition and Measurement of Financial Assets and Financial* Liabilities, and *ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging*.

Staff Review Completed by:

William Oden, NAIC Staff – December 2022

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification to reject *ASU 2022-05, Transition for Sold Contracts* in *SSAP No. 50–Classifications of Insurance or Managed Care Contracts; SSAP No. 51R—Life Contracts; SSAP No. 52—Deposit-Type Contracts; SSAP No. 56—Separate Accounts; SSAP No. 71—Policy Acquisition Costs and Commissions* and *SSAP No. 86—Derivatives*, which is consistent with prior agenda items related to this topic.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/3-22-23 - Spring/Exposures/23-10 - ASU 2022-05 - Sold Contracts.docx