**Fall National Meeting - Review of GAAP Exposures for Statutory Accounting:**

Pursuant to a 2014 direction from the SAPWG chair, there is a desire for the Statutory Accounting Principles (E) Working Group to be more proactive in considering FASB exposures that may be significant to statutory accounting and reporting. Historically, the SAPWG has commented on limited, key FASB exposures – mostly pertaining to insurance contracts and financial instruments. To ensure consideration of all FASB exposures, staff prepared this memorandum to highlight the current exposures, comment deadlines, and to provide a high-level summary of the exposed item’s potential impact to statutory accounting. It is anticipated that this information would assist the Working Group in determining whether a comment letter should be submitted to the FASB on the issues. Regardless of the Working Group’s election to submit comments to the FASB on proposed accounting standards, under the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process, issued US GAAP guidance noted in the hierarchy within Section V of the Preamble to the *Accounting Practices and Procedures Manual* must be considered by the Statutory Accounting Principles (E) Working Group.

FASB Exposures: [Exposure Documents and Public Comment Documents (fasb.org)](https://www.fasb.org/projects/documents-open-for-comments)

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| **Exposed FASB Guidance** | **Comment Deadline & Initial Staff Comments** |
| Proposed Accounting Standards Update—Derivatives and Hedging (Topic 815): Hedge Accounting Improvements | November 25, 2024 |

The FASB is issuing this proposed Update to clarify certain aspects of the guidance on hedge accounting and to address several incremental hedge accounting issues arising from the global reference rate reform initiative.

In 2017, the FASB issued Accounting Standards Update No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, to better portray the economic results of an entity’s risk management activities in its financial statements and to make certain targeted improvements to simplify the application of the hedge accounting guidance. After the issuance of Update 2017-12, stakeholders asked the Board to clarify certain aspects of the guidance in the amendments of that Update. In 2019, the Board issued a proposed Accounting Standards Update, Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting, to clarify certain areas of the guidance to better align with the objective articulated in Update 2017-12.

Stakeholders indicated that the amendments in the 2019 proposed Update would not sufficiently resolve certain issues and that additional clarity was needed. In addition, in response to the 2021 Invitation to Comment, Agenda Consultation, stakeholders expressed concerns that current guidance increases the prevalence of missed forecasted transactions for otherwise highly effective hedging relationships, thus resulting in less decision-useful information for investors. Stakeholders also identified several areas of hedge accounting guidance requiring further updates to address the effects of reference rate reform on hedge accounting.

Consistent with the original objective of Update 2017-12, the objective of this proposed Update is to more closely align hedge accounting with the economics of an entity’s risk management activities. The amendments included in the five issues addressed in this proposed Update are intended to better reflect those strategies in financial reporting by enabling entities to achieve and maintain hedge accounting for a greater number of highly effective economic hedges. The proposed amendments would limit the occurrence of unintuitive de-designation events and missed forecasted transactions for those hedging relationships. The amendments in this proposed Update would apply to any entity that elects to apply hedge accounting in accordance with Topic 815.

Issue 1: Similar Risk Assessment for Cash Flow Hedges

The amendments in this proposed Update would expand the hedged risks permitted to be aggregated in a group of individual forecasted transactions in a cash flow hedge by changing the requirement to designate a group of individual forecasted transactions from having a shared risk exposure to having a similar risk exposure. Entities would be required to assess risk similarity both at hedge inception and on an ongoing basis. The proposed amendments also would clarify that a group of individual forecasted transactions would be considered to have a similar risk exposure if the derivative used as the hedging instrument is highly effective against each risk in the group. In addition, in some cases, entities would be permitted to perform an ongoing qualitative assessment of whether a group of individual forecasted transactions has a similar risk exposure on a hedge-by-hedge basis.

The amendments in this proposed Update would improve GAAP by expanding the hedged risks permitted to be aggregated in a group of individual forecasted transactions, thereby enabling entities to apply hedge accounting to broader portfolios of forecasted transactions. Entities would be able to apply hedge accounting in a more efficient, cost-effective manner while reducing the risk of missed forecasts for highly effective economic hedges. Furthermore, clarifying the application of the similar risk assessment would improve operability and help entities apply the guidance more consistently. Therefore, investors would have more relevant information about entities’ risk management activities related to cash flow hedges of groups of forecasted transactions.

Issue 2: Hedging Forecasted Interest Payments on Choose-Your-Rate Debt Instruments

The amendments in this proposed Update would facilitate the application of the change in hedged risk guidance to cash flow hedges of forecasted interest payments on variable-rate debt instruments with contractual terms that permit the borrower to change the interest rate index and interest rate tenor (that is, reset frequency) upon which interest is accrued (commonly referred to as “choose-your-rate” debt instruments). The contractual terms of the debt agreement would determine the alternative interest rate indexes and interest rate tenors that an entity may select during the hedging relationship without needing to discontinue hedge accounting. In addition, the proposed amendments would permit entities to use simplified assumptions when assessing hedge effectiveness and the probability of forecasted transactions occurring. Entities would be prohibited from applying this simplified guidance by analogy to other circumstances.

The amendments in this proposed Update would improve GAAP by establishing an operable model to address a pervasive hedging strategy for which stakeholders highlighted that diversity in practice exists. Furthermore, the amendments would enable entities to reduce the risk of hedge de-designation events and missed forecasts, while broadening the application of hedge accounting. As a result, entities would be able to more consistently reflect risk management strategies in the financial information provided to investors.

Issue 3: Cash Flow Hedges of Nonfinancial Forecasted Transactions

The amendments in this proposed Update would expand hedge accounting for forecasted purchases and sales of nonfinancial assets. Entities would be permitted to designate variable price components of the forecasted purchase or sale of a nonfinancial asset that meet the clearly-and-closely-related criteria would permit hedge accounting for eligible components of forecasted spot-market transactions and subcomponents of explicitly referenced components in an agreement’s pricing formula.

The amendments in this proposed Update would improve GAAP because the application of hedge accounting would not necessarily be limited by whether the nonfinancial purchase or sale transaction is executed in the spot or forward market. Furthermore, the proposed amendments also may enable entities to reduce the risk of missed forecasts for highly effective economic hedges, more closely aligning entities’ risk management strategies with hedge accounting to better reflect those strategies in financial reporting. The amendments in this proposed Update also would clarify that entities may designate a variable price component in a contract that is accounted for as a derivative as the hedged risk if the associated forecasted purchase or sale of the nonfinancial asset qualifies to be a hedged forecasted transaction. That clarification would improve GAAP because it would resolve diversity in practice about whether hedge accounting may be applied in those situations and would allow hedge accounting to be applied to highly effective economic hedges.

Issue 4: Net Written Options as Hedging Instruments

The amendments in this proposed Update would permit compound derivatives composed of a written option and a non-option derivative (for example, an interest rate swap with a written cap or floor) to qualify for designation as a hedging instrument in a cash flow hedge by adjusting the eligibility criteria for when a net written option may be designated as a hedging instrument. The proposed amendments would permit an entity to assume that certain terms of the hedged forecasted transactions match those of the hedging instrument for purposes of applying the net written option test.

The amendments in this proposed Update would improve GAAP by making the net written option test more operable for hedging relationships involving a variable-rate loan with an interest rate floor hedged by an interest rate swap that contains a mirror-image interest rate floor. The proposed amendments would accomplish that by allowing simplifying assumptions to be made that would accommodate differences in the loan and swap markets that exist after the cessation of the London Interbank Offered Rate (LIBOR). Making those simplifying assumptions would allow entities to continue to apply hedge accounting for strategies involving compound derivatives composed of a written option and a non-option derivative after LIBOR cessation.

Issue 5: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)

The amendments in this proposed Update would eliminate the recognition and presentation mismatch related to a dual hedge strategy (that is, a hedge for which a foreign-currency-denominated debt instrument is both designated as the hedging instrument in a net investment hedge and designated as the hedged item in a fair value hedge of interest rate risk). The proposed amendments would require that an entity exclude the debt instrument’s fair value hedge basis adjustment from the net investment hedge effectiveness assessment. As a result, an entity would immediately recognize in earnings the gains and losses from the remeasurement of the debt instrument’s fair value hedge basis adjustment at the spot exchange rate. Entities would be prohibited from applying this guidance by analogy to other circumstances.

The amendments in this proposed Update would improve GAAP by enabling entities that utilize dual hedging strategies to reflect the economic offset of changes attributable to both interest rate risk and foreign exchange risk. The effective date for the amendments in this proposed Update will be determined after the Board considers stakeholders’ feedback on the proposed amendments. The amendments in this proposed Update would require that an entity apply the guidance on a prospective basis for existing hedging relationships as of the date of adoption. Early adoption would be permitted for all entities on any date on or after issuance of a final Update. Upon adoption of the amendments in this proposed Update, entities may either be required or permitted to modify critical terms of certain existing hedging relationships, without de-designating the hedge.

**Staff Review and Commentary:**

Comment deadline is November 25, 2024

NAIC staff recommend that ASU be reviewed under the SAP Maintenance Process as detailed in *Appendix F—Policy Statements.*

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| **Exposed FASB Guidance** | **Comment Deadline & Initial Staff Comments** |
| Proposed Accounting Standards Update—Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Clarifications to Share-Based Consideration Payable to a Customer | November 14, 2024 |

The Board is issuing this guidance to reduce diversity in practice and improve the decision usefulness and operability of the guidance for share-based consideration payable to a customer in conjunction with selling goods or services.

Some entities offer to provide consideration to a customer (or to other parties that purchase the entity’s goods or services from the customer) to incentivize the customer (or its customers) to purchase goods and services. Although consideration payable to a customer often takes the form of cash or credit that can be applied against amounts owed to the entity, it also can take the form of equity instruments (or other types of share-based consideration) such as warrants. When share-based consideration is granted to a customer (a grantee), it often vests upon the grantee purchasing a specified volume or monetary amount of goods and services from the grantor.

The guidance in Topic 606, Revenue from Contracts with Customers, requires that an entity account for consideration payable to a customer as a reduction of the transaction price and, therefore, as a reduction of revenue unless the payment to the customer is in exchange for a distinct good or service.

The amendments in Accounting Standards Update No. 2019-08, Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer, require that a grantor apply the guidance in Topic 718, Compensation—Stock Compensation, to measure and classify share-based consideration payable to a customer (the “Topic 718 approach”). Those amendments also require that if share-based consideration payable to a customer contains vesting conditions, the grantor must determine whether the vesting conditions represent service conditions or performance conditions. That determination can affect when the grantor recognizes revenue because it is required to estimate the probable outcome of a performance condition (and, therefore, whether the share-based consideration is expected to vest or is expected to be forfeited). By contrast, for service conditions, instead of estimating forfeitures, a grantor can elect to account for forfeitures as they occur. When the grantor elects to account for forfeitures as they occur, revenue recognition may be delayed for awards that are not probable of vesting.

Stakeholders indicated that this delay in revenue recognition can diminish the decision usefulness of a grantor’s revenue information. For example, revenue may be recognized upon the forfeiture of warrants that were not expected to vest. Therefore, revenue may be recognized several reporting periods after the grantor has satisfied the related performance obligation(s), even if in that time there has been no change in the likelihood that the award will vest. Stakeholders also noted that the current guidance for forfeitures can increase the differences in financial reporting outcomes between share-based consideration payable to a customer and other forms of consideration payable to a customer (including cash consideration).

Under current guidance, there is diversity in practice in determining whether certain conditions (for example, those based on customer purchases) are service conditions or performance conditions. Therefore, stakeholders asked that the Board clarify how to distinguish between service conditions and performance conditions. Stakeholders also asked the Board to more closely align how forfeitures of share-based consideration with service conditions and forfeitures of share-based consideration with performance conditions affect the measurement of the transaction price (which affects revenue recognition timing) to improve the operability of the guidance and the decision usefulness of the resulting financial reporting information.

The amendments in this proposed Update would affect all entities that issue share-based consideration to a customer that is within the scope of Topic 606.

Under current GAAP, the definitions of performance condition and service condition do not explicitly discuss purchases made by a customer or parties that purchase a grantor’s goods or services from the grantor’s customers. For share-based consideration payable to a customer (including share-based consideration payable to other parties that purchase the grantor’s goods or services from the grantor’s customers) with a service condition, current GAAP permits the grantor to elect to account for the effect of forfeitures as they occur, which may result in a delay in revenue recognition for awards that are not probable of vesting. In addition, current GAAP also does not explicitly state whether the guidance in Topic 606 on constraining estimates of variable consideration applies to share-based consideration payable to a customer that is measured and classified under the Topic 718 approach.

The amendments in this proposed Update would revise the Master Glossary definition of the term performance condition for share-based consideration payable to a customer. The revised definition would incorporate conditions (including vesting conditions) that are based on the volume, monetary amount, or timing of a customer’s purchases of goods or services from the grantor. The revised definition also would incorporate performance targets based on the volume of purchases made by other parties that purchase the grantor’s goods or services from the grantor’s customers.

Although proportionally fewer customer awards would be expected to have service conditions, for those that do have service conditions, the amendments in this proposed Update would eliminate the policy election permitting a grantor to account for forfeitures as they occur. Therefore, when measuring share-based consideration payable to a customer that has a service condition, the grantor would be required to estimate the number of forfeitures expected to occur. Separate policy elections for forfeitures would remain available for share-based payment awards with service conditions granted to employees and non-employees in exchange for goods or services to be used or consumed in the grantor’s own operations.

The amendments in this proposed Update would clarify that share-based consideration encompasses the same instruments as share-based payment arrangements but the grantee would not need to be a supplier of goods or services to the grantor.

Finally, the amendments in this proposed Update would clarify that, under the Topic 718 approach, a grantor should not apply the guidance in Topic 606 on constraining estimates of variable consideration to share-based consideration payable to a customer. Therefore, a grantor would be required to assess the probability that an award will vest using only the guidance in Topic 718.

Collectively, these changes would improve the decision usefulness of a grantor’s financial statements, improve the operability of the guidance, and reduce diversity in practice for accounting for share-based consideration payable to a customer. Under the proposed amendments, revenue recognition would no longer be delayed when an entity grants awards that are not expected to vest. This is expected to result in estimates of the transaction price that better reflect the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer and, therefore, more decision-useful financial reporting.

The amendments in this proposed Update would permit a grantor to apply the new guidance on either a modified retrospective or a retrospective basis. When applying the amendments in this proposed Update on a modified retrospective basis, a grantor would be required to recognize a cumulative effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) as of the beginning of the period of adoption and would not recast any financial statement information before the period of adoption. A grantor would apply the proposed amendments as of the date of initial application to all share-based consideration payable to a customer. When applying the amendments in this proposed Update on a retrospective basis, a grantor would be required to recast comparative periods and recognize a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) as of the beginning of the earliest period presented.

The effective date and whether early application should be permitted will be determined after the Board considers stakeholders’ feedback on this proposed Update.

**Staff Review and Commentary:**

Comment deadline is November 14, 2024

NAIC staff recommend that ASU be reviewed under the SAP Maintenance Process as detailed in *Appendix F—Policy Statements.*

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/11-17-24 Fall National Meeting/Meeting/H - Review of GAAP Exposures.docx