EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: July 14, 2022
Comments Due: August 8, 2022

Financial Services—Insurance (Topic 944)

Transition for Sold Contracts

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 944 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2022-003, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until August 8, 2022. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2022-003
- Sending a letter to "Technical Director, File Reference No. 2022-003, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

Financial Services—Insurance (Topic 944)

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July 14, 2022

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CONTENTS

Page Numbers

Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The Board issued Accounting Standards Update No. 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts* (LDTI), in August 2018. The amendments in Update 2018-12 require an insurance entity to apply a retrospective transition method as of the beginning of the earliest period presented or the beginning of the prior fiscal year if early application is elected. The Board received stakeholder feedback indicating that applying the LDTI guidance to contracts that were derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date likely would not provide decision-useful information to investors and other financial statement users and may result in significant operability challenges for insurance entities to apply the guidance.

As such, the Board is issuing this proposed Update to reduce implementation costs and complexity associated with the adoption of LDTI for contracts that have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date. Otherwise, an insurance entity would be required to reclassify a portion of the previously recognized gains or losses to the LDTI transition adjustment because of the adoption of a new accounting standard. Because there is no effect on an insurance entity's future cash flows, such a reclassification could be misleading to financial statement users.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect insurance entities that have derecognized contracts because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date. The LDTI effective dates, as amended by Accounting Standards Update No. 2020-11, *Financial Services—Insurance (Topic 944): Effective Date and Early Application*, are as follows:

1. For public business entities that meet the definition of a U.S. Securities and Exchange Commission (SEC) filer and are not smaller reporting companies, LDTI is effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Early application is permitted.

2. For all other entities, LDTI is effective for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. Early application is permitted.

What Are the Main Provisions?

The amendments in this proposed Update would amend the LDTI transition guidance to allow an insurance entity to make an accounting policy election to exclude contracts that meet certain criteria from applying the amendments in Update 2018-12 when they have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date.

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

Currently, the LDTI guidance is required to be applied retrospectively to the earliest period presented or as of the beginning of the prior fiscal year if early application is elected.

If the LDTI guidance was applied to contracts that have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date, preparers would have to communicate why previously recognized gains or losses have changed because of the adoption of a new accounting standard. In the Board's view, that likely would not provide decision-useful information to investors and other financial statement users.

When Would the Amendments Be Effective?

The effective dates of the amendments in this proposed Update would be consistent with the effective dates of the amendments in Update 2020-11.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1—Information Usefulness: Would the amendments in this proposed Update reduce costs without significantly reducing the decision-useful information for investors and other financial statement users? Please explain why or why not.

Question 2—Election Level: Do you agree that the accounting policy election, if elected by an insurance entity, should be consistently applied to all contracts that have been derecognized subject to the scope of the proposed amendments? Please explain why or why not.

Question 3—Contracts: Do you agree that the proposed amendments should apply only to contracts that have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date? Please explain why or why not.

Question 4—Continuing Involvement: Do you agree that the accounting policy election should apply only when an insurance entity has no continuing involvement with the derecognized contracts other than as permitted in the proposed amendments? If not, please explain what forms of continuing involvement should be allowed or prohibited.

Question 5—Disclosures: Do you agree with the proposed disclosure requirements? Please explain why or why not.

Question 6—Operability: Are the proposed amendments operable and auditable? If not, which proposed amendments pose operability or auditability concerns and why?

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraph 2. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Subtopic 944-40

2. Amend paragraph 944-40-65-2 by adding items (q) through (t) and amend its related heading as follows:

Financial Services—Insurance—Claim Costs and Liabilities for Future Policy Benefits

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Updates No. 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts,* No. 2019-09, *Financial Services—Insurance (Topic 944): Effective Date,* ~~and~~ No. 2020-11, *Financial Services—Insurance (Topic 944): Effective Date and Early Application*, and No. 2022-XX, *Financial Services—Insurance (Topic 944): Transition for Sold Contracts*

944-40-65-2 The following represents the transition and effective date information related to Accounting Standards Updates No. 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, No. 2019-09, *Financial Services—Insurance (Topic 944): Effective Date*, ~~and~~ No. 2020-11, *Financial Services—Insurance (Topic 944): Effective Date and Early Application*, and No. 2022-XX, *Financial Services—Insurance (Topic 944): Transition for Sold Contracts*:

Contracts derecognized before the effective date because of sale or disposal

q. An insurance entity may make an accounting policy election to exclude from the pending content that links to this paragraph certain contracts that meet all the following as of the effective date:

1. The contracts have been derecognized because of a sale or disposal. The sale or disposal may be on an individual contract basis, on a group basis, or on a legal entity basis.
2. The insurance entity has no continuing involvement with the derecognized contracts.

r. The following are forms of continuing involvement that would not meet the criteria in (q)(2) and would prohibit an insurance entity from applying the accounting policy election:
   1. A direct or indirect interest in an equity method investee or a consolidated entity that provides significant influence or continuing significant exposure to the risks and rewards of the derecognized contracts.
   2. Any other arrangement that allows for significant participation in the ongoing performance of the derecognized contract.

s. The following are examples that would not be considered continuing involvement as described in (q)(2) and therefore would allow an insurance entity to apply the accounting policy election:
   1. Investment management, policy servicing, or other administrative arrangements.
   2. Standard merger and acquisition representations and warranties.

t. The accounting policy election shall be consistently applied to all contracts that meet the criteria in (q). An insurance entity shall disclose the following in the notes to financial statements:
   1. Whether it made the accounting policy election.
   2. A qualitative description of the sale or disposal transaction to which the insurance entity applied the accounting policy election.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. The Board issued Update 2018-12 in August 2018 to improve, simplify, and enhance the financial reporting requirements for long-duration contracts issued by insurance entities. The effective dates of LDTI, as amended by Update 2020-11, are as follows:

a. For public business entities that meet the definition of an SEC filer and are not smaller reporting companies, LDTI is effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Early application is permitted.
b. For all other entities, LDTI is effective for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. Early application is permitted.

BC3. The LDTI guidance requires retrospective transition. Specifically, an insurance entity is required to apply the LDTI guidance as of the beginning of the earliest period presented or as of the beginning of the prior fiscal year if early application is elected.

BC4. The Board is issuing the amendments in this proposed Update in response to stakeholder concerns that applying the LDTI guidance to contracts that have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date likely would not provide decision-useful information to investors and may result in significant operational challenges for insurance entities to apply the guidance.

Benefits and Costs

BC5. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC6. The Board concluded that the expected benefits of the amendments in this proposed Update would justify the expected costs. Financial statement users would benefit from the proposed amendments because they would not require an insurance entity to change previously recognized gains or losses recorded upon the derecognition of contracts because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date. Otherwise, an insurance entity would be required to reclassify a portion of the previously recognized gains or losses to the LDTI transition adjustment because of the adoption of a new accounting standard. Because there is no effect on the insurance entity's future cash flows, such a reclassification could be misleading to financial statement users.

BC7. Additionally, the amendments in this proposed Update would reduce the cost and complexity of applying the LDTI guidance for insurance entities. The proposed amendments are optional so an insurance entity that has substantially completed its implementation of the LDTI guidance would not need to incur additional costs to unwind aspects of its LDTI transition that relate to contracts that have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date. Therefore, the Board believes that entities would not incur significant costs as a result of the proposed amendments.

Basis for Conclusions

Accounting Policy Election

BC8. The Board is proposing to amend the LDTI transition guidance to allow an insurance entity to make an accounting policy election to exclude certain contracts or legal entities from applying the transition guidance when they have been derecognized because (a) of a sale or disposal before the LDTI effective date and (b) the insurance entity has no continuing involvement with the derecognized contracts.

BC9. Without the proposed accounting policy election, preparers would have to explain (and investors would have to understand) the effect of adopting the LDTI guidance on already derecognized contracts with no future cash flows to the insurance entity. Furthermore, stakeholders indicated that there would be a significant burden on both preparers and practitioners to apply the LDTI guidance to contracts derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date. Because necessary resources (such as personnel with technical expertise, systems, and historical records) are often transferred to the buyer upon the close of a sale or disposal transaction, preparers may incur significant financial and operability costs to comply with the LDTI guidance for contracts derecognized in those circumstances.

BC10. The Board is proposing optional guidance rather than mandatory guidance to not impose significant costs on preparers that may have already completed (or are nearing completion of) their LDTI implementation efforts for contracts derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date. Otherwise, preparers in those circumstances would have to incur additional costs to reverse the implementation work already completed.

BC11. When initially determining the scope of the proposed accounting policy election, the Board considered if a determinative factor should be whether the derecognized contracts or legal entities met the classification requirements of held for sale or discontinued operations before the contracts were derecognized. The Board decided that the classification of discontinued operations or held for sale was not a determinative factor. The Board concluded that the determinative factor is whether upon the LDTI effective date the contracts are still recognized on the balance sheet of the insurance entity and whether the insurance entity continues to have significant exposure to the risks and rewards of those contracts.

BC12. The Board received feedback that insurance entities that have continuing involvement with the derecognized contracts or sold or disposed of legal entities should not qualify for the accounting policy election. The Board considered the different types of continuing involvement that could arise and specified certain examples that would not be considered continuing involvement for purposes of applying the accounting policy election. That guidance is not intended to be analogized beyond this proposed Update. The Board decided that the criterion of no continuing involvement was important to ensure that entities that enter into transactions to alter the financial statement impact of adopting LDTI while retaining some or all of the risks and rewards of the sold contracts are not eligible to apply the accounting policy election.

BC13. The Board believes that the following are forms of continuing involvement and therefore would prohibit an insurance entity from applying the accounting policy election:

a. A direct or indirect interest in an equity method investee or a consolidated entity that provides significant influence or continuing significant exposure to the risks and rewards of the derecognized contracts
b. Any other arrangement that allows for significant participation in the ongoing performance of the derecognized contract.

BC14. The Board believes that under the amendments in this proposed Update, the following examples would not be considered continuing involvement with the derecognized contracts and therefore would allow an insurance entity to apply the accounting policy election:

a. Investment management, policy servicing, or other administrative arrangements
b. Standard merger and acquisition representations and warranties.

Disclosure

BC15. Chapter 8, *Notes to Financial Statements*, of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, provides possible information for the Board to consider when deciding on the disclosure requirements for a Topic in the Codification. The amendments in this proposed Update are the result of the Board's consideration of the guidance in Chapter 8 of Concepts Statement 8 as well as feedback received from outreach with stakeholders.

BC16. The Board decided to require disclosure of the accounting policy election in this proposed Update to inform users when an insurance entity has applied the accounting policy election.

BC17. The Board decided not to require disclosure of the gain or loss on contracts derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date when electing to apply the amendments in this proposed Update because there is existing guidance that requires the gains or losses on the sale or disposal transaction to be disclosed if not separately presented on the face of financial statements. Therefore, requiring a similar disclosure in this proposed Update would have been redundant.

Effective Date and Transition

BC18. The Board decided that the amendments in this proposed Update should be adopted concurrently with the adoption of the amendments in Update 2018-12, as amended by Update 2020-11.

Amendments to the GAAP Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the "GAAP Taxonomy"). We welcome comments on these proposed improvements to the GAAP Taxonomy at xbrled@fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the GAAP Taxonomy will be finalized as part of the annual release process.