FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2022-05
December 2022

Financial Services—Insurance (Topic 944)

Transition for Sold Contracts

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This 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 that an insurance entity 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 allocators of capital and may result in significant operability challenges for insurance entities to apply the guidance.

As a result, the Board is issuing this Update to reduce implementation costs and complexity associated with the adoption of LDTI for contracts that have been derecognized in accordance with the amendments in this Update before the LDTI effective date. Without the amendments in this Update, 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 may not be decision useful to investors and other allocators of capital.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect insurance entities that have derecognized contracts 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 Update 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 Update 2018-12. 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.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They 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 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 have provided decision-useful information to investors and other allocators of capital.

When Will the Amendments Be Effective and What Are the Transition Requirements?

The effective dates of the amendments in this Update are consistent with the effective dates of the amendments in Update 2020-11.

Amendments to the *FASB Accounting Standards Codification®*

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2 and 3. 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 (u) 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. 2022-05, *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. 2022-05, *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 significant continuing involvement with the derecognized contracts.

r. The following are forms of significant continuing involvement that would not meet the criterion in (q)(2) and would prohibit an insurance entity from applying the accounting policy election:
   1. An interest that provides significant influence over the derecognized contracts. To determine whether significant influence exists, an insurance entity shall consider the guidance in paragraphs 323-10-15-6 through 15-11, including for equity ownership interests that are not within the scope of that guidance.
   2. Any other arrangement that allows for significant participation in the derecognized contracts.

s. The following are examples that would not be considered significant 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. An insurance entity shall apply the accounting policy election to all contracts within a sale or disposal transaction that meet the criteria in (q). The accounting policy election shall be applied at the sale or disposal transaction level.

u. If an insurance entity qualifies for and elects to apply the accounting policy election in (q), the insurance entity shall disclose in the notes to financial statements a qualitative description of each sale or disposal transaction to which it applied the accounting policy election.

Amendments to Status Sections

3. Amend paragraph 944-40-00-1, by adding the following item to the table, as follows:

944-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	**Action**	**Accounting Standards Update**	**Date**
944-40-65-2	Amended	2022-05	12/15/2022

The amendments in this Update were adopted 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 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 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 investors or other allocators of capital with decision-useful information and may result in significant operability challenges for insurance entities to apply the guidance.

BC5. On July 14, 2022, the Board issued proposed Accounting Standards Update, *Financial Services—Insurance (Topic 944): Transition for Sold Contracts*, with comments due on August 8, 2022. The Board received 11 comment letters in response to the amendments in the proposed Update. Overall, respondents supported the proposed amendments, noting that they would reduce costs and could enhance the decision-useful information for investors and other allocators of capital. The Board considered respondents' comments in reaching the conclusions in this Update, as discussed further below.

Benefits and Costs

BC6. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other allocators of capital 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 allocators of capital benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors and other allocators of capital. 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.

BC7. The Board concluded that the expected benefits of the amendments in this Update justify the expected costs. Investors and other allocators of capital will benefit from the amendments because they do not require that an insurance entity 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 have been 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 would not provide decision-useful information to investors and other allocators of capital.

BC8. Additionally, the amendments in this Update reduce the cost and complexity of applying the LDTI guidance for insurance entities. The amendments are optional and can be applied at the transaction level. Therefore, an insurance entity that has substantially completed its implementation of the LDTI guidance (for all or certain transactions) will 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, in the Board's view, adoption of the amendments will help facilitate the adoption of LDTI.

Basis for Conclusions

Accounting Policy Election

BC9. The Board amended the LDTI transition guidance to allow an insurance entity to make an accounting policy election on a transaction-by-transaction basis to exclude certain contracts or legal entities from applying the transition guidance because (a) of a sale or disposal and (b) the insurance entity has no significant continuing involvement with the derecognized contracts before the LDTI effective date.

BC10. Without the accounting policy election, preparers would have had to explain (and investors or other allocators of capital would have had 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 have incurred significant financial and operability costs to comply with the LDTI guidance for contracts derecognized in those circumstances.

BC11. The Board added 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 had to incur additional costs to reverse the implementation work already completed. Comment letter respondents agreed with an optional accounting policy election.

BC12. The Board had originally proposed applying the election on an entity-wide basis. However, some stakeholders recommended that the accounting policy election should be permitted on a transaction-by-transaction basis rather than on an entity-wide basis. For example, an insurance entity may elect to apply the accounting policy election at the sale or disposal transaction level as opposed to every sale or disposal transaction made by the entity. Stakeholders noted that given the current late stage of LDTI implementation, an insurance entity may have completed implementation efforts for some contracts disposed of during the transition period but not others, and it would be costly to reverse already completed work. Some Board members did not support permitting the accounting policy election to be applied on a transaction-by-transaction basis unless an entity was required to disclose which transactions it applied the accounting policy election to and which transactions it did not. The Board ultimately concluded that the objective of the project was to facilitate the adoption of the LDTI guidance and that allowing the election to be applied on a transaction-by-transaction basis most closely aligned with that objective. The Board also decided to require that an insurance entity disclose each sale or disposal transaction to which it applied the accounting policy election.

BC13. When determining the scope of the 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 held for sale or discontinued operations 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 has significant continuing involvement with the derecognized contracts. Some comment letter respondents asked that the Board clarify whether recaptures or contracts that were derecognized because of early termination were within the scope of the amendments in the proposed Update. The Board affirmed that only contracts that have been derecognized because of a sale or disposal should be subject to the accounting policy election, which would exclude terminations and recaptures.

BC14. During initial project research, 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. Several comment letter respondents noted that the examples provided in the amendments in the proposed Update were more indicative of significant continuing involvement. On the basis of that feedback, the Board decided to clarify that insurance entities that have significant continuing involvement with the derecognized or sold contracts or disposed of legal entities should not qualify for the accounting policy election.

BC15. Comment letter respondents asked the Board to clarify its intent with the example in the amendments in the proposed Update (see paragraph 944-40-65-2(r)(1)) that would prohibit an insurance entity from applying the accounting policy election if the insurance entity had a direct or indirect interest in an equity method investee. The Board's intent was to allow an insurance entity that holds an investment in the counterparty to a sale transaction but does not have the ability to exercise significant influence to be able to apply the accounting policy election. Respondents further noted that, in accordance with SEC guidance (paragraph 323-30-S99-1), public insurance entities with an investment in a limited partnership would likely be precluded from applying the accounting policy election, since limited partnership investments of more than 3 to 5 percent are accounted for under the equity method of accounting. In the Board's view, for purposes of applying the accounting policy election, insurance entities should assess significant influence using the guidance in paragraphs 323-10-15-6 through 15-11, regardless of the form of the equity ownership interest.

BC16. The amendments in this Update are not intended to be analogized beyond this Update. The Board decided that the criterion of no significant 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.

BC17. The Board noted that the following are forms of significant continuing involvement that prohibit an insurance entity from applying the accounting policy election:

a. An interest that provides significant influence over the derecognized contracts. To determine whether significant influence exists, an insurance entity is required to consider the guidance in paragraphs 323-10-15-6 through 15-11, including for equity ownership interests that are not within the scope of that guidance.
b. Any other arrangement that allows for significant participation in the derecognized contracts.

BC18. The Board noted that under the amendments in this Update, the following examples are not considered significant continuing involvement with the derecognized contracts and therefore 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

BC19. 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 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.

BC20. The Board decided to require disclosure of the accounting policy election in this Update to inform users when an insurance entity has applied the accounting policy election. To do so, the Board decided to require that entities disclose a qualitative description of each sale or disposal transaction to which the insurance entity applied the accounting policy election.

BC21. 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 Update because there is existing guidance that requires that the gains or losses on the sale or disposal transaction be disclosed if not separately presented on the face of financial statements. Therefore, requiring a similar disclosure in this Update would have been redundant.

Effective Date and Transition

BC22. The Board decided that the amendments in this 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 amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the "GAAP Taxonomy"). Those improvements, which will be incorporated into the proposed 2023 GAAP Taxonomy, are available through GAAP Taxonomy Improvements provided at www.fasb.org, and finalized as part of the annual release process.