

To the Point

FASB – proposed guidance

FASB scales back scope of insurance contracts project

The FASB will focus on improving the accounting for long-duration contracts and disclosures for short-duration contracts.

What you need to know

- ▶ The FASB scaled back the scope of its insurance contracts project and said it will focus on targeted improvements to the current guidance for long-duration contracts and disclosures for short-duration contracts.
- ▶ Contracts written by noninsurance entities will not be subject to the guidance for insurance. At a future date, the FASB may consider whether to require noninsurance entities to apply the insurance guidance to certain contracts they write.
- ▶ Entities will continue to apply today's measurement and recognition guidance to short-duration contracts such as property and casualty, short-term health, mortgage, financial guarantee and title insurance contracts.

Overview

The Financial Accounting Standards Board (FASB or Board) scaled back the scope of its insurance contracts project in response to feedback from constituents that any benefits from applying the proposed guidance to all contracts that met a new definition of an insurance contract would not outweigh the cost of implementing it.

Of most concern were contracts written by noninsurance entities such as banks and commercial entities and non-life insurance contracts written by insurance companies. As a result, the Board decided to focus on improving recognition, measurement and disclosures for long-duration insurance contracts and improving disclosures for short-duration contracts.



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The FASB also indicated that the project would no longer focus on converging US GAAP and IFRS. The FASB proposal was based on a new model it developed jointly with the International Accounting Standards Board (IASB), but the FASB and the IASB issued separate proposals after disagreeing on some key points. The IASB is moving ahead with its proposal.

Key considerations

Noninsurance entities

The FASB had proposed guidance that would have applied to all entities that issue contracts that met a new definition of insurance, including reinsurance ceded and assumed.

When the Board reconsidered that decision at its meeting this week, the Board decided that requiring all entities to apply the insurance contracts guidance but excluding certain contracts would be too complex. Several Board members noted that the Securities and Exchange Commission's advisory committee on improving financial reporting had recommended that accounting guidance focus on transactions rather than industries and should have only a limited number of scope exceptions.

Six of the seven FASB members voted to make the guidance specific to insurance companies at this time. However, the Board indicated it may consider at a future date whether certain contracts issued by noninsurance entities that have the same characteristics as insurance should be explicitly scoped into the guidance on insurance.

The Board may consider at a later date whether certain contracts should be explicitly scoped into the insurance guidance.

How we see it

While the Board considered the merits of guidance based on transactions, the Board decided to maintain an industry approach in this project because a transaction approach would require an excessive number of scope exceptions.

Long-duration insurance contracts

The FASB proposal would have replaced the multiple long-duration models that are applied to life insurance under current US GAAP with a single model called the building block approach. It also would have moved US GAAP and IFRS closer together.

Some Board members indicated that when the FASB began deliberations with the IASB, the starting point was a model the IASB had already developed. These Board members said the FASB should analyze US GAAP and focus on improvements rather than just redeliberate the building block approach. The majority of FASB members acknowledged that this analysis could result in targeted improvements to US GAAP that are similar to the building block approach but address constituents' concerns.

Three FASB members voted to continue working with the IASB on the building block approach to minimize differences between US GAAP and IFRS. One Board member noted that many life insurers are global entities and would have to follow both US GAAP and IFRS, which would be costly. However, the majority of Board members said they were skeptical that the FASB could achieve convergence because the IASB plans to discuss only a few topics in redeliberations.

How we see it

Any targeted improvements to US GAAP would likely address concerns the FASB has previously discussed, such as eliminating multiple models, updating assumptions, accounting for all cash flows that are part of a contract, using current market rates and recognizing revenue in a manner that is similar to the revenue recognition guidance the Boards have jointly developed.

Short-duration insurance contracts

Five FASB members voted to focus on improving disclosures for short-duration contracts. One member voted to make no changes to the short-duration model, while another Board member voted to focus on targeted improvements to the recognition, measurement and disclosures for these contracts.

The Board indicated that new disclosures may include a loss development table and other items based on the measurement concepts in the proposal. The Board also indicated that it hopes to address reinsurance issues by focusing on the definition of insurance as part of the improvements to the long-duration contracts. The Board had previously put a reinsurance project on hold because it intended to address the accounting for the underlying contracts in the insurance contracts project.

How we see it

In deciding to focus only on disclosures for short-duration contracts, the Board noted that insurers and users of the financial statements said the current model provides reasonable measurement and recognition guidance.

Any change to the definition of insurance that the FASB makes for long-duration contracts could affect an entity's ability to use today's short-duration model.

What's next

The FASB directed the staff to analyze existing US GAAP guidance for insurance entities and identify potential areas for improvement. The staff also will provide the Board with potential disclosure improvements for short-duration contracts. It's unclear whether the FASB will hold joint redeliberations on life insurance contracts in March, as scheduled.

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