Working Draft

Targeted Improvements to Long-Duration Contracts Implementation Paper

Issue #6: **Use of Discount Rates or Yield Curve for interest accretion on Insurance Liabilities under ASU 2018-12.**

Wording to be Included in the Audit and Accounting Guide: Life and Health Insurance Entities.

Long-Duration Contracts

1. In accordance with FASB ASC 944-40-30-7, in determining the level of aggregation at which the liability for future policy benefits are calculated, it is acceptable to aggregate individual contracts within specific parameters. The level of aggregation for measurement of the liability for future policy benefits is referred to herein as the "cohort." See Implementation Paper #16: *Level of Aggregation for the Measurement of the Liability for Future Policy Benefits*, for considerations for determining cohorts for the liability for future policy benefits.

Discount Rate

2. FASB ASC 944-40-30-9 states:

   The liability for future policy benefits shall be discounted using an upper-medium grade (low-credit-risk) fixed-income instrument yield. An insurance entity shall consider reliable information in estimating the upper-medium grade (low-credit-risk) fixed-income instrument yield that reflects the duration characteristics of the liability for future policy benefits (see paragraph 944-40-55-13E). An insurance entity shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs in determining the discount rate assumption.

3. FASB ASC 944-40-55-13E states:

   An insurance entity should maximize the use of current observable market prices of upper-medium-grade (low-credit-risk) fixed-income instruments with durations similar to the liability for future policy benefits.

   a. An insurance entity should not substitute its own estimates for observable market data unless the market data reflect transactions that are not orderly (see paragraphs 820-10-35-54I through 35-54J for additional guidance on determining whether transactions are not orderly).
   b. In determining points on the yield curve for which there are limited or no observable market data for upper-medium-grade (low-credit-risk) fixed-income instruments, an insurance entity should use an estimate that is consistent with existing guidance on fair value measurement in Topic 820, particularly for Level 3 fair value measurement.

4. FASB ASC 944-40-35-6A(b) states:

b. Discount rate assumptions. Net premiums shall not be updated for discount rate assumption changes.
    i. The difference between the updated carrying amount of the liability for future policy benefits (that is, the present value of future benefits and expenses less the present value of future net premiums based on updated cash flow assumptions) measured using the updated discount rate assumption and the original discount rate assumption shall be recognized directly to other comprehensive income (that is, on an immediate basis).
    ii. The interest accretion rate shall remain the original discount rate used at contract issue date.

5. For business issued after the transition date (i.e., new business), when determining initial discount rate assumptions and setting the interest accretion rate for the liability for future policy benefits, FinREC believes it is appropriate to use either a yield curve or the equivalent level rate to reflect the duration characteristics of the liability for future policy benefits in accordance with FASB ASC 944-40-30-9. FinREC believes that once an insurer has selected the interest accretion rate (which includes the method used to determine the interest accretion rate, i.e., either a yield curve or an equivalent level rate), FASB ASC 944-40-35-6A(b)(2) prohibits the insurer from changing the interest accretion rate (including the method used to determine the accretion rate) in a subsequent measurement period for that existing cohort. That is, the selection of the interest accretion rate (including the method of determining the rate) constitutes an irrevocable election made at contract issuance. Generally these principles are collectively referred to as a “locked-in” interest accretion rate.

6. FinREC also believes that all contracts within a cohort (which are issued at various times throughout the period to which the cohort relates) are not required to use the same (weighted average) locked-in interest accretion rate. Separate yield curves or equivalent level rates may be used for individual contracts, or groups of contracts, consistently applied within a cohort, which is effectively equivalent to using a weighted average interest accretion rate for the cohort.

7. When determining the interest accretion rate and current discount rate on the liability for future policy benefits where market data for an upper-medium grade (low-credit-risk) fixed-income instrument yield is limited or not observable (e.g., in certain foreign jurisdictions), as noted in FASB ASC 944-40-55-13E the discount rate should be estimated consistent with existing guidance on fair value measurement in ASC 820. Consistent with paragraph BC65 of the Background Information and Basis for Conclusions of FASB ASU 2018-12, FinREC believes that in applying FASB ASC 820 guidance, an entity should adjust an observable input for characteristics that are different from the characteristics being measured (e.g., adjust the rate, which is not an upper-medium grade fixed-income instrument yield for differences in credit) to estimate an upper-medium grade (low-credit-risk) fixed-income instrument yield.

Transition

8. FASB ASC 944-40-65-2(d)(1) states:
    d. For the liability for future policy benefits:
        1. For purposes of determining the ratio of net premiums to gross premiums and for purposes of interest accretion, an insurance entity shall retain the discount rate assumption that was used to calculate the liability immediately before the application of the pending content that links to this paragraph.

9. When applying the modified retrospective approach under FASB ASC 944-40-65-2d(1) to contracts issued before the transition date, consistent with paragraph 5, FinREC believes it is not acceptable to change the interest accretion rate used to calculate the liability immediately before

the transition date (including the method used to determine the interest accretion rate, e.g. from use of an equivalent level rate to a curve or from a curve to an equivalent level rate).

Comments should be received by July 29, 2021, and sent by electronic mail to Kim Kushmerick at kim.kushmerick@aicpa-cima.com, or you can send them by mail to attention: Kim Kushmerick, 1345 Avenue of the Americas, New York, N.Y., 10105.