SSAP CHAT live.

Texas Insurance Industry 2022 Update

Statutory & GAAP

Learning Objectives

1. 2022 Statutory Discussion & Changes on the Horizon
2. 2022 Status Update of New and Pending GAAP
3. How these items may impact your current and future audits

The Statutory Front

Proposed Bond Definition – more info

- Initiated October 2020
- Project goal = principle-based guidance for determining bonds belonging in Schedule D category
- **MAJOR CHANGE** – segregate Sch D-1 reporting of CREDIT obligations & ASSET-BACKED securities
- PROPOSED TARGET DATE = **January 1, 2025**
- SSAP 26R is proposed to contain the entire bond definition – NO further definition in SSAP 43R – prevents inconsistencies between the two standards
- What about securities that were treated as bonds, no longer qualify, and must be reported elsewhere?
- No more ABS securities can be reported on Schedule DA or Cash Equivalents – SSAP 2R – *Cash, Cash Equivalents, Drafts and Short-Term Investments* to be modified
- SSAP 21R – *Other Admitted Assets* - new guidance inserted for securities that no longer qualify

Change in Long-standing SAP Terminology

- Adopted 12/2021 and effective 01/01/2022
- Changes the long-standing terminology tradition in APP Manual
- What has been called "Substantive" will now be called "New SAP Concept"
- What has been called "Non-substantive" will now be called "SAP Clarification"

2022 SAP Audits – Getting the Jump on Your Auditor

2022 SAP Audits – Getting the Jump on Your Auditor

- ✓ Unrealized losses – current conditions suggest greater audit concentration on impairment issues

- ✓ Unrealized losses – deferred tax – how are you projecting 3-year unrealized loss recoveries for DTA admission?

- ✓ P&C insurers – SSAP 62, ¶76 - Ceding Commission Paid **>** actual acquisition costs of ceded business
  (Example: piling the kitchen sink into INTERNAL acquisition costs...**<u>Hint:</u>** review GAAP definition of qualifying acquisition costs ASU 2010-26; FASB ASC 944-30-55)

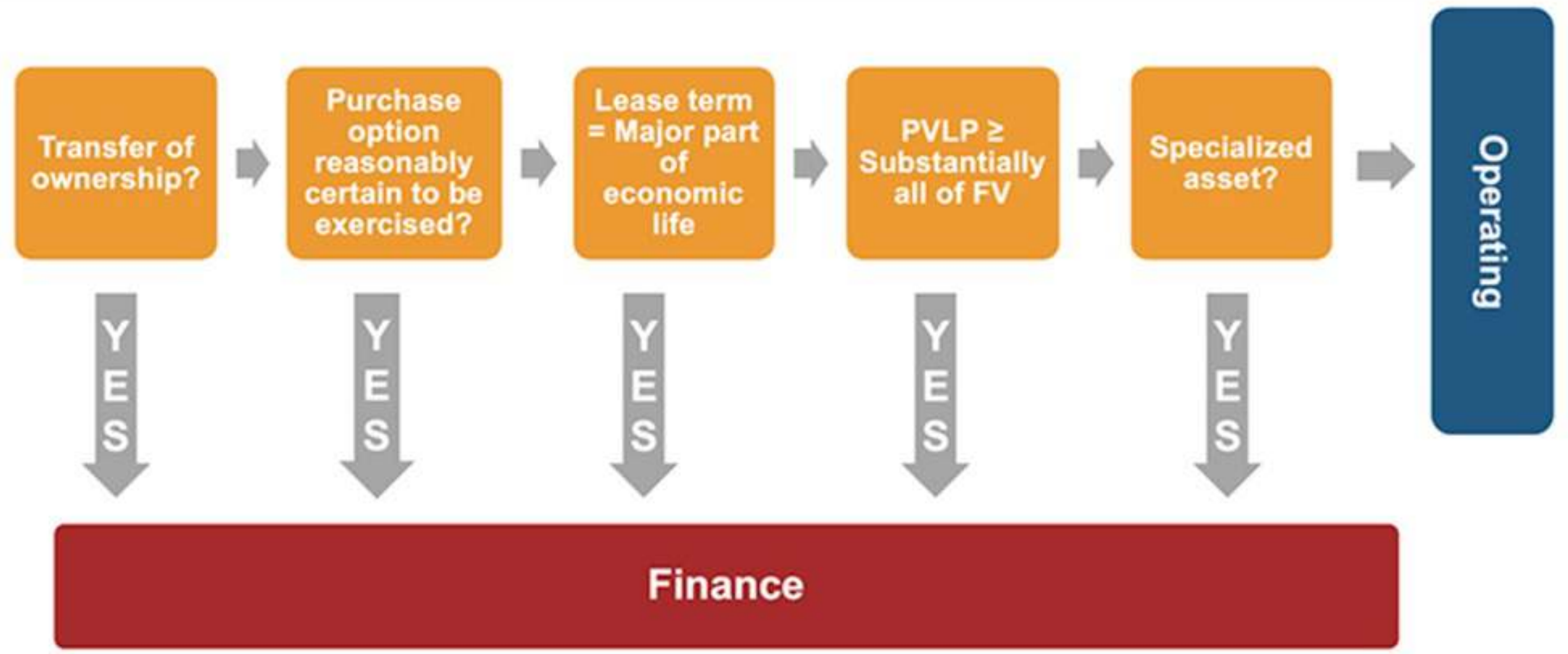
- ✓ Schedule BA assets – got audit? - much more alternative activity in this arena in recent years

- ✓ Schedule BA assets – conforming to domicile state investment code? (**Hint:** DO NOT assume investment advisor has it covered...VERIFY IT!)

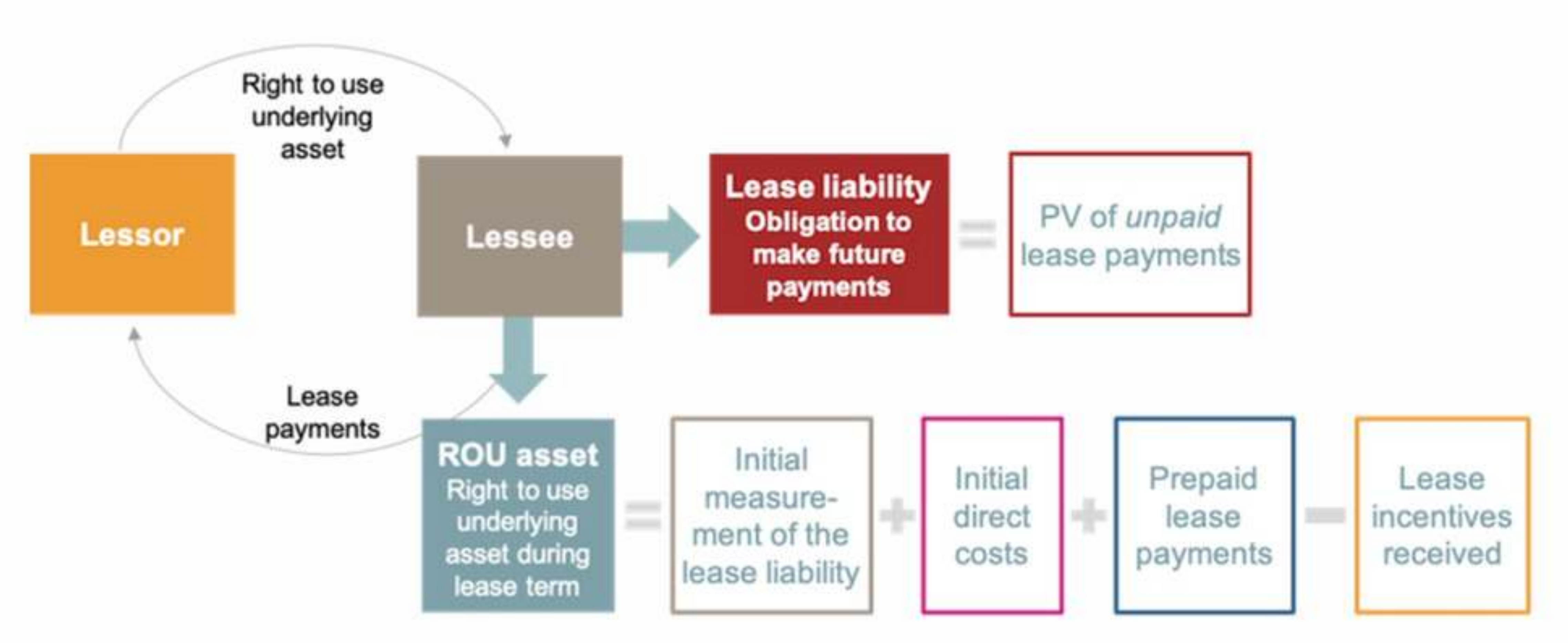
The GAAP Front

Nonpublic Companies

Leases


Transfer of ownership?
Purchase option reasonably certain to be exercised?
Lease term = Major part of economic life
PVLP ≥ Substantially all of FV
Specialized asset?
Operating
YES
YES
YES
YES
YES
Finance

Leases



Right to use underlying asset
Lessor
Lessee
Lease payments
Lease liability Obligation to make future payments
=
PV of *unpaid* lease payments
ROU asset Right to use underlying asset during lease term
=
Initial measure-ment of the lease liability
+
Initial direct costs
+
Prepaid lease payments
−
Lease incentives received

Leases

	Finance Lease	Operating Lease
Expense recognized in the income statement	Sum of interest expense and amortization expense	Straight-line rent expense

Periodic expense is variable

Periodic expense is constant

Straight line expense − Interest = Amortization

Income Taxes, ASU 2019-12, (Topic 740): Simplifying the Accounting for Income Taxes

- Hybrid Tax Regimes
- Tax Basis Step-Up in Goodwill Obtained in a Transaction That Is Not a Business Combination
- Separate Financial Statements of Legal Entities Not Subject to Tax
- Intraperiod Tax Allocation Exception to Incremental Approach
- Ownership Changes in Investments — Changes From a Subsidiary to an Equity Method Investment
- Ownership Changes in Investments — Changes From an Equity Method Investment to a Subsidiary
- Interim-Period Accounting for Enacted Changes in Tax Law
- Year-to-Date Loss Limitation in Interim-Period Tax Accounting

Nonpublic Companies

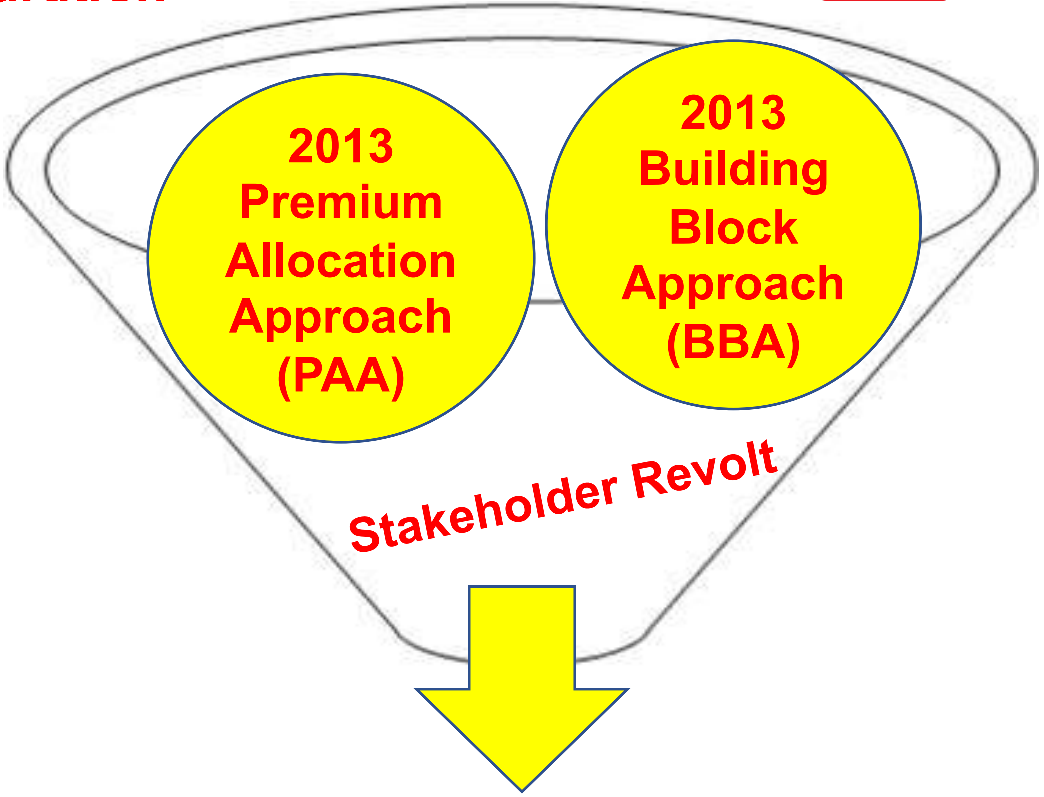
Credit Losses ASU 2016-03	Codification Improvements Various ASUs	Franchisors Revenue ASU 2021-02	Troubled Debt Restructuring ASU 2022-02	Fair Value of Equity Securities ASU 2022-03	
Long-duration contracts ASU 2018-12	Goodwill Impairment ASU 2017-04	Convertible Instruments ASU 2020-06	Contract Assets and Contract Liabilities ASU 2021-08	Fair Value Hedging 2022-01	Supplier Finance Program Obligations 2022-04

Future - Beyond 2022

ASU 2018-12

Targeted Improvements – Accounting for Long-Duration Contracts Issued by Insurance Companies

- ✓ The design process began in 2007
- ✓ Original non-public timing = 2022
  Subsequently - POSTPONED
- ✓ Now on the horizon for 2025 implementation
  (non-public)



- ➢ ASU 2015-09 – TOPIC 944 – Disclosures – Short-Duration Contracts
- ➢ ASU 2018-12 – TOPIC 944 – Targeted Improvements-Accounting for Long-Duration Contracts

ASU 2018-12

Targeted Improvements – Accounting for Long-Duration Contracts Issued by Insurance Companies

- ✓ **Purpose =** Improve, simplify and enhance GAAP financial reporting for long duration contracts to assist users in understanding amount, timing and uncertainty of cash flows
- ✓ **A compromise transition** from the previous comprehensive attempt to completely revamp the accounting for insurance contracts
- ✓ Applies to long-duration contracts – ***life, disability income, long-term care, annuities***
- ✓ **Key components** =
  - Requires **periodic update (annually)** of assumptions used to measure future policy benefit liability
  - **Simplified amortization** of deferred acquisition costs
  - **Discount rate** = upper medium grade fixed income yield (A+ S&P/ A1 Moody's) rather than Co yield
  - Consistent measurement of market risk benefits
  - Enhanced disclosures – liability roll-forward, DAC assumptions, other significant assumptions

AREA OF FOCUS	TARGET	IMPROVEMENT
Liability for future policy benefits	Original assumptions remain "locked"	Assumptions periodically updated
	Discount rate is the insurer's expected investment yield	Discount rate is high-quality fixed-income instrument yield
Market risk benefits (variable products)	Two measurement models	One measurement model
Deferred acquisition costs	Complex amortization	Simplified amortization
Disclosures	Limited disclosures	Enhanced disclosures

ASU 2018-12 – Preparing Internally

- **NO GAAP? NO SWEAT!**

- **A critical collaborative effort between actuary and financial reporting**

- **Inquire with internal actuary or independent consulting actuary for a timeline and YOU establish the EXECUTION timeline**

- **Some key differences to consider**
  - No more provision for **risk of adverse deviation**
  - No more **premium deficiency reserve**
  - DAC – constant amortization – **basically straight-line amortization**
  - DAC – **no longer accrual of interest** on unamortized balance
  - Rates used for discounting liability for future policy benefits now uses an observable market rate

ASU 2018-12 – Update Since Issuance

Proposed ASU – Transition for Sold Contracts

- Insurance entity allowed to elect to exclude contracts DERECOGNIZED before the LDTI effective date (Informal Hint: you would be crazy if you didn't)
- Applies to insurance contracts (policies) sold, OR sale of an entity, prior to LDTI effective date
- WHY? Does not provide relevant information going forward since no future cash flows
- WHY? In such cases, supporting resources (personnel, systems, records, expertise) are most likely transferred to buyer on sale
- FASB Board minutes 09/22/2022 affirmed this will be codified in 4th quarter 2022

Credit Losses

- ASU 2016-13, as amended
- Effective for years beginning after December 15, 2022 = Next year 2023

Incurred Loss Model	Current Expected Credit Loss (CECL) Model
Recognition of credit losses when it is probable the loss has been incurred	Recognize credit losses at inception for losses expected over the entire term of a financial instrument

Credit Losses

Apply CECL

- Loans and notes receivable
- Premiums receivable
- Securities held to maturity
- Lessor receivables from sales type and direct financing leases
- Receivables related to repurchase and securities lending
- Reinsurance recoverable

Do not Apply CECL

- Policy loans
- Receivables between entities under common control
- Securities available for sale ***
- Equity securities
- Financial assets measured at fair value through net income (derivatives)
- Lessor receivables from operating leases

*** Revised impairment model

Credit Losses

- Available for Sale Debt Securities
  - Not CECL but revised impairment model
    - Impairment is limited to excess of amortized cost over fair value
    - Allowance (contra asset) for impairment provided through earnings
    - Fluctuations in fair value not charged to allowance (unrealized gains and losses) provide through other comprehensive income

Goodwill

Step 0

Qualitative Assessment: Is reporting unit fair value more likely than not, less than its carrying amount?

Step 1

Quantitative assessment: Is reporting unit fair value less than its carrying amount?

~~Step 2~~

~~Quantitative assessment: Does the carrying value of goodwill exceed the implied fair value of goodwill?~~

~~If yes, recognize a goodwill impairment for any excess of the goodwill's carrying value over its implied value~~

Goodwill

Step 0

Qualitative Assessment: Is reporting unit fair value more likely than not, less than its carrying amount?

Step 1

Quantitative assessment: Is reporting unit fair value less than its carrying amount?

If yes, recognize a goodwill impairment for the difference between the carrying amount of the reporting unit and its fair value, not to exceed the carrying amount of goodwill

Goodwill

Private Company Alternative

0	1	2	3	4
0 Amortize	1 Has a triggering event occurred that would indicate the fair value may be impaired?	2 Qualitative Assessment: Is reporting unit fair value more likely than not, less than its carrying amount?	3 Quantitative assessment: Is reporting unit far value less than its carrying amount?	4 If yes, recognize an impairment for the difference between the carrying amount of the reporting unit and its fair value, not to exceed the carrying amount of goodwill

Goodwill

FASB Project, Identifiable Intangible Assets and Subsequent Accounting for Goodwill,

- Tentative decisions to date:
  - Amortize goodwill on a straight-line basis over a 10-year default period or over an estimated period (using an open list of factors to consider), limited to a 25-year cap
  - Reassessing the amortization period would be prohibited

Dead, at least for now

Questions?