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FASB Provides Implementation Relief Related to ASU 2018-12's Transition Guidance for Derecognized Contracts

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Introduction

On December 15, 2022, the FASB issued [ASU 2022-05](#),¹ which introduces an optional accounting policy election under which insurers can choose not to apply the amendments made by [ASU 2018-12](#)² to certain contracts that are derecognized as a result of a sale or disposal before the effective date of ASU 2018-12. Insurers that make this accounting policy election would also be subject to additional disclosure requirements.

Background

On August 5, 2018, the FASB issued ASU 2018-12 (the "LDTI guidance") to make targeted improvements to its guidance on long-duration contracts issued by an insurance entity in response to stakeholder feedback indicating that more timely, transparent, and decision-useful information about long-duration contracts was needed.

[ASU 2019-09](#)³ and [ASU 2020-11](#)⁴ amended ASU 2018-12 to defer its effective date. Stakeholders raised concerns regarding applying the LDTI guidance to contracts sold or disposed of before this guidance's effective date. They noted that the costs incurred by preparers in adopting the LDTI guidance for contracts that have been derecognized because of sale or disposal before its effective date may not exceed the benefits from the adoption of this guidance.

¹ FASB Accounting Standards Update (ASU) No. 2022-05, *Financial Services — Insurance (Topic 944): Transition for Sold Contracts*.

² FASB Accounting Standards Update No. 2018-12, *Financial Services — Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts ("LDTI")*.

³ FASB Accounting Standards Update No. 2019-09, *Financial Services — Insurance (Topic 944): Effective Date [of LDTI]*.

⁴ FASB Accounting Standards Update No. 2020-11, *Financial Services — Insurance (Topic 944): Effective Date and Early Application [of LDTI]*.

ASU 2022-05 is intended to ease the potential implementation burden of adopting the LDTI guidance for contracts sold or disposed of before the LDTI guidance's effective date. Specifically, the new ASU amends ASC 944-40-65-2⁵ to give insurers the option of electing, as an accounting policy, not to apply the LDTI guidance to contracts (i.e., individual contracts, group of contracts, or legal entities) derecognized before the LDTI guidance's effective date because of sale or disposal when certain criteria are met.

Main Provisions of ASU 2022-05

The ASU amends the LDTI transition guidance on contracts derecognized as a result of sale or disposal before the LDTI guidance's effective date and provides an optional accounting policy election under which such contracts would be excluded from the scope of the LDTI guidance if the insurance entity does not have significant continuing involvement with the derecognized contracts.

Examples of significant continuing involvement under the ASU include:

- "An interest that provides [the insurer with] significant influence over the derecognized contracts."
- "Any other arrangement that allows for significant participation in the derecognized contracts."

However, the following would not be considered significant continuing involvement under the ASU:

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



Connecting the Dots

ASU 2022-05 indicates that insurers should consider the guidance in ASC 323-10 in determining whether investments provide an insurer with significant influence in derecognized contracts. Specifically, the ASU notes that insurers should apply ASC 323-10-15-6 through 15-11 in determining whether significant influence exists in the context of applying the ASU's policy election. An insurer would apply the guidance in ASC 323-10-15-6 through 15-11 in making this determination even if the equity ownership interest would be accounted for under U.S. GAAP other than ASC 323-10. Such investments would include, for example, investments by insurance entities in limited partnerships of more than 3 percent to 5 percent that are accounted for under the equity method under ASC 323-30 if the investments do not provide the insurer with significant influence in accordance with ASC 323-10-15-6 through 15-11.⁶

By including the references to the guidance in ASC 323-10, the Board intends to give an insurance entity that holds an investment in the counterparty to a sale transaction, but does not have the ability to exercise significant influence over those contracts, the option of applying the accounting policy election.

The reason why the Board made the ASU's accounting policy election optional rather than mandatory was to alleviate potential costs for preparers whose LDTI implementation efforts are complete or nearly complete and who would therefore incur costs in reversing these efforts.

⁵ For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#)."

⁶ Paragraph BC15 of ASU 2022-05.

Insurers can apply this policy on a transaction-by-transaction basis, and the election is limited to contracts derecognized because of sale or disposal events. Classification as held for sale or discontinued operations is not determinative in application of the ASU's scope.⁷

Under the ASU, insurers that apply the accounting policy election in this ASU must also disclose a qualitative description of each sale or disposal transaction to which the optional election was applied.

Effective Dates

ASU 2022-05 is effective for all entities that adopt ASU 2018-12 (as amended). Specifically, the effective dates are as follows:

- For public business entities that meet the definition of an SEC filer and are not smaller reporting companies, fiscal years beginning after December 15, 2022, and interim periods within those fiscal years.
- For all other entities, fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025.

The guidance may be early adopted if an entity has adopted ASU 2018-12 for the corresponding period.

⁷ Paragraph BC13 of ASU 2022-05.

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