Insurers Get Transition Relief on Classification & Measurement Rules

While the effective date has arrived for public business entities (PBE) to implement Accounting Standards Update (ASU) 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, the Financial Accounting Standards Board (FASB) has only recently finalized a set of technical corrections in ASU 2018-03. Buried in the amendments is transition relief and clarity for insurance entities. For a comprehensive review of ASU 2016-01, see **BKD Thoughtware**® article, "Ready for the New Classification and Measurement Rules for Financial Instruments."

ASU 2016-01 created a new universal practical expedient for nonmarketable equity securities, *i.e.*, investments measured at cost today. If elected, entities would record those securities at cost adjusted for impairment and increases or decreases in observable prices for orderly transactions for a similar investment of the same issuer.

Insurance companies' investment portfolios currently benefit from industry-specific relief for equity securities without a readily determinable fair value (RDFV)—such securities are required to be measured at fair value with changes in fair value recorded in accumulated other comprehensive income (AOCI). ASU 2016-01 eliminated this industry-specific guidance.

Retrospective transition was required (cumulative effect adjustment to the opening retained earnings on adoption); however, as originally issued, prospective transition was required for any equity securities without RDFV at the adoption date. Insurance companies faced an operational challenge upon adoption—the standard did not lay out the accounting for amounts previously recorded in AOCI under current insurance-specific guidance.

The technical corrections clarify prospective transition only was meant for instances in which the measurement alternative is applied. Insurance companies not electing the expedient would continue to measure equity security without RDFV at fair value under ASC 820 and transition would be a modified retrospective approach with a cumulative effect adjustment upon adoption.

Insurance entities electing the practical expedient will prospectively reclassify related AOCI balances to net income. FASB clarified there is not one prescribed methodology to prospectively recognize these amounts. There are many acceptable alternatives that may include, but are not limited to:

- AOCI is frozen and fully released when the security is sold. All subsequent impairments and adjustments for observable transactions after the adoption date would be recorded through earnings.
- AOCI is fully released at the first instance of identified impairment or an observable transaction.
- AOCI is released incrementally to offset fair value changes. For example, if a security was in an unrealized gain position at the adoption date and there is a subsequent impairment identified, the entity would release the portion of AOCI that offsets the amount of the impairment. If the effect of the impairments exceeds the amount deferred in AOCI, this excess would be recorded in current period earnings. If the same security in an unrealized gain position at the adoption date had an observable transaction indicating an increase in the security's value, the AOCI would remain unchanged and the gain would be recorded in current period earnings.

An insurer should apply its selected prospective transition method consistently to its entire population of equity securities for which the measurement alternative is elected.

To allow entities to continue their current adoption plans for ASU 2016-01, the effective dates for the technical corrections include relief for interim reporting for PBEs.

Effective Dates ASU 2016-01	**PBEs** Annual and interim reporting periods beginning after December 15, 2017	**All Others** Annual reporting periods beginning after December 15, 2018 Interim periods beginning after December 15, 2019
Effective Dates ASU 2018-03	**PBEs** Annual reporting periods beginning after December 15, 2017 Interim periods beginning after June 15, 2018	**All Others** Annual reporting periods beginning after December 15, 2018 Interim periods beginning after December 15, 2019

PBEs with fiscal years beginning in the period between December 15, 2017, and June 15, 2018, would not be required to adopt ASU 2018-03 until the interim period beginning after June 15, 2018. PBEs are required to use a retrospective transition approach and make a cumulative effect adjustment back to the effective date of ASU 2016-01.

For all other entities, the amendments would have the same effective date and transition requirements as ASU 2016-01. Entities that have adopted ASU 2016-01 would be allowed to early adopt the amendments.

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