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No. 2010-15
April 2010

Financial Services—Insurance (Topic 944)

How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*™

Financial Accounting Standards Board
of the Financial Accounting Foundation

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The objective of this Update is to address practice questions on how investments held through the separate accounts of an insurance entity affect the consolidation analysis under *FASB Accounting Standards Codification*™ Subtopic 810-10, Consolidation—Overall.

Separate accounts represent assets that are typically maintained by a life insurance entity for purposes of funding obligations to individual contract holders under fixed-benefit or variable annuity contracts, pension plans, and similar contracts. The contract holder generally assumes the investment risk, and the insurance entity receives a fee for investment management, certain administrative expenses, and mortality and expense risks assumed. The accounting for separate accounts is outlined in Subtopic 944-80, Financial Services—Insurance—Separate Accounts. That Subtopic requires that the portion of separate account assets representing contract holder funds be measured at fair value and reported in the insurance entity's financial statements as a summary total, with an equivalent summary total reported for related liabilities, if all of the following criteria in paragraph 944-80-25-2 are met:

1. The separate account is recognized legally; that is, the separate account is established, approved, and regulated under special rules such as state insurance laws, federal securities laws, or similar foreign laws.
2. The separate account assets supporting the contract liabilities are insulated legally from the general account liabilities of the insurance entity; that is, the contract holder is not subject to insurer default risk to the extent of the assets held in the separate account.
3. The insurer must, as a result of contractual, statutory, or regulatory requirements, invest the contract holder's funds within the separate account as directed by the contract holder in designated investment alternatives or in accordance with specific investment objectives or policies.
4. All investment performance, net of contract fees and assessments, must as a result of contractual, statutory, or regulatory requirements be passed through to the individual contract holder. Contracts may specify conditions under which there may be a minimum guarantee but not a ceiling, because a ceiling would prohibit all investment performance from being passed through to the contract holder.

A separate account is not a distinct legal entity, but rather an accounting entity created by and under the control of an insurance entity that owns 100 percent of the assets held in the separate account. The separate account arrangement legally isolates certain assets backing variable contracts from the other assets of the insurance entity (the other assets of the insurance entity are held in the general account of the insurer). The main reason for this structure is to protect assets backing the separate account component of variable contracts from the general creditors of the insurance entity if the insurance entity becomes insolvent.

While the insurance entity cannot make investment allocation decisions for contract holders, the insurance entity does hold title to the investments in a separate account and generally has certain rights associated with those investments, such as the ability to vote on behalf of the contract holder. Separate accounts operate similar to a mutual fund and invest in assets that match the investment objective of the insurance contracts that the separate account assets fund, including individual securities, real estate, and mutual funds. An insurance entity also may invest separately in the same investments through its general account or through its interest in the separate account.

Certain separate accounts are required to issue standalone financial statements and are considered investment companies for financial reporting purposes. As discussed in paragraph 810-10-15-10(a)(3), consolidation by an investment company within the scope of Topic 946, Financial Services—Investment Companies, of a non-investment-company investee is not permitted except for certain subsidiaries that provide services to the investment company. Paragraph 810-10-25-15 states that the application of guidance in an industry-specific Topic of the Codification to a subsidiary within the scope of that industry-specific Topic should be retained in consolidation of that subsidiary. Accordingly, if the separate account was a legal entity and was considered an investment company for financial reporting purposes, the insurer would apply this guidance and generally would not consolidate the investments held by the separate accounts. However, because a separate account is not always a separate legal entity and may not be required to prepare separate standalone financial statements, it was not clear whether the guidance in Topic 810 applies to all separate accounts.

Additionally, it was not clear whether an insurance entity should combine its general account interest with the separate account interest when assessing whether the insurer has a controlling financial interest in the investment and should therefore consolidate that investment in its financial statements. Also, since the issuance of U.S. generally accepted accounting principles (GAAP) on noncontrolling interests in Topic 810, questions have arisen about how to present any noncontrolling interests if the investment is consolidated.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect insurance entities that have separate accounts that meet the definition of a separate account in paragraph 944-80-25-2 when evaluating whether to consolidate an investment held through its separate account or through a combination of investments in its separate and general accounts. The accounting for situations in which an insurer’s general account has a controlling financial interest in an investment is not affected by the amendments in this Update and should follow existing GAAP on consolidations.

The amendments in this Update are specific to insurance entities that have separate accounts and should not be analogized by other entities in non-separate-account arrangements or other investment situations.

What Are the Main Provisions?

Accounting Guidance

The amendments in this Update clarify that an insurance entity should not consider any separate account interests held for the benefit of policy holders in an investment to be the insurer’s interests and should not combine those interests with its general account interest in the same investment when assessing the investment for consolidation, unless the separate account interests are held for the benefit of a related party policy holder as defined in the Variable Interest Subsections of Subtopic 810-10 and those Subsections require the consideration of related parties.

This Update provides amendments to Subtopic 944-80 to clarify that for the purpose of evaluating whether the retention of specialized accounting for investments in consolidation is appropriate, a separate account arrangement should be considered a subsidiary. Additionally, the amendments do not require an insurer to consolidate an investment in which a separate account holds a controlling financial interest if the investment is not or would not be consolidated in the standalone financial statements of the separate account.

The amendments in this Update also provide guidance on how an insurer should consolidate an investment fund in situations in which the insurer concludes that consolidation is required.

Disclosures

The amendments in this Update do not modify the disclosures currently required by GAAP.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The amendments in this Update clarify that the specialized industry accounting that applies to investment companies and that is retained in consolidation by noninvestment company parents should apply to separate account arrangements that meet the definition of an investment company in their separate financial statements or would meet such a definition if they issued separate financial statements. Additionally, by adding specific guidance to GAAP, the amendments will assist preparers in evaluating how investments in an entity that are held through an insurance company's separate accounts will affect its consolidation analysis. In addition, the guidance will assist preparers in presenting any noncontrolling interest if the investment is consolidated. Clarifying that guidance should improve current GAAP by limiting potential diversity in practice. The amendments should not unnecessarily increase the complexity of an insurer's financial statements and should provide financial statement users with useful information.

When Will the Amendments Be Effective?

The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2010. Early adoption is permitted. The amendments in this Update should be applied retrospectively to all prior periods upon the date of adoption.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

The amendments in this Update may result in differences in accounting and reporting between GAAP and IFRS because IFRS does not specifically address the accounting by insurance entities. In addition, the IFRS consolidation requirements in International Accounting Standard 27, *Consolidated and Separate Financial Statements,* and IASC Standing Interpretations Committee 12, *Consolidation—Special Purpose Entities,* are applied to entities that are considered investment companies for GAAP purposes. Insurance entities that follow IFRS may reach different consolidation conclusions.

Amendments to the *FASB Accounting Standards Codification*™

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–6. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 944-80

2. Amend paragraph 944-80-25-3, with a link to transition paragraph 944-80-65-1, as follows:

Financial Services—Insurance—Separate Accounts

Recognition

944-80-25-2 The guidance in the following paragraph applies if the **separate account arrangement** meets all of the following conditions:

a. The separate account is recognized legally; that is, the separate account is established, approved, and regulated under special rules such as state insurance laws, federal securities laws, or similar foreign laws.
b. The separate account assets supporting the contract liabilities are insulated legally from the **general account** liabilities of the insurance entity; that is, the contract holder is not subject to insurer default risk to the extent of the assets held in the separate account.
c. The insurer must, as a result of contractual, statutory, or regulatory requirements, invest the contract holder's funds within the separate account as directed by the contract holder in designated investment alternatives or in accordance with specific investment objectives or policies.
d. All investment performance, net of contract fees and assessments, must as a result of contractual, statutory, or regulatory requirements be passed through to the individual contract holder. Contracts may specify conditions under which there may be a minimum guarantee, but not a

ceiling, as a ceiling would prohibit all investment performance from being passed through to the contract holder.

944-80-25-3 All of the following guidance applies if a separate account arrangement meets all of the conditions in the preceding paragraph:

a. The portion of separate account assets representing contract holder funds shall be reported in the insurance entity's financial statements as a summary total, with an equivalent summary total reported for related liabilities.
b. Any liabilities related to minimum guarantees and insurance benefit liabilities under the contracts in excess of the **fair value** of separate account assets representing contract holder funds shall be recognized as general account liabilities.
c. Contract fees and assessments shall be reported in accordance with paragraph 944-605-25-5.
d. For the purpose of evaluating the retention of specialized accounting for investments in consolidation as described in paragraph 810-10-25-15, a separate account arrangement shall be considered a subsidiary. An insurer is not required to consolidate an investment in which a separate account holds a controlling financial interest if the investment is not or would not be consolidated in the standalone financial statements of the separate account.
e. Except as described in paragraph (f), the insurer shall not do either of the following when assessing whether the insurer is required to consolidate an investment held by a separate account:
    1. Consider any separate account interests held for the benefit of policy holders to be the insurer's interests
    2. Combine any separate account interests held for the benefit of policy holders with the insurer's general account interest in the same investment.
f. Separate account interests held for the benefit of a related party policy holder shall be combined with the insurer's general account interest when the Variable Interest Entities Subsections of Subtopic 810-10 require the consideration of related parties. For this purpose, a related party includes any party identified in paragraph 810-10-25-43 other than:
    1. An employee of the decision maker or service provider (and its other related parties), except if the employee is used in an effort to circumvent the provisions of Subtopic 810-10
    2. An employee benefit plan of the decision maker or service provider (and its other related parties), except if the employee benefit plan is used in an effort to circumvent the provisions of Subtopic 810-10.

3. Add paragraph 944-80-25-12 and its related heading, with a link to transition paragraph 944-80-65-1, as follows:

> Consolidation of an Investment Fund When Separate Accounts Are Involved

944-80-25-12 If an insurer concludes that an investment fund should be consolidated and a portion of the fund is owned by the insurer's separate accounts, the insurer should consolidate the investment fund in the following manner:

a. The portion of the fund assets representing the contract holder's interests shall be included as separate account assets and liabilities in accordance with paragraph 944-80-25-3.
b. The remaining portion of the fund assets (including the portion owned by any other investors) shall be included in the general account of the insurer on a line-by-line basis. For example, if the consolidated fund held debt and equity securities, those amounts would be included in the debt and securities lines.
c. Noncontrolling interests should not be included in the separate account liability but rather classified as a liability or equity based on other applicable guidance.

4. Supersede paragraph 944-80-55-7, with a link to transition paragraph 944-80-65-1, as follows:

Implementation Guidance and Illustrations

944-80-55-7 Paragraph superseded by Accounting Standards Update 2010-15. ~~Accounting for equity investments, including mutual funds, would depend on percentage ownership. If Subaccount XYZ owns more than 50 percent of the outstanding shares of a mutual fund, the accounting and classification of the items included in the column titled Separate Account at General Account Value would reflect consolidating the mutual fund into Subaccount XYZ. That is, if the mutual fund held debt and equity securities, those amounts would be included in the debt and equity securities lines of the table in the following paragraph.~~

5. Add paragraph 944-80-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2010-15, *Financial Services—Insurance (Topic 944): How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments*

944-80-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-15, *Financial Services—Insurance (Topic 944): How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments:*

a. The pending content that links to this paragraph shall be applied retrospectively in fiscal years beginning after December 15, 2010, and interim periods within those fiscal years.
b. Earlier application is permitted.
c. The disclosures in paragraphs 250-10-50-1 through 50-3 shall be provided.

6. Add paragraph 944-80-00-1 as follows:

944-80-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	**Action**	**Accounting Standards Update**	**Date**
944-80-25-3	Amended	2010-15	04/21/2010
944-80-25-12	Added	2010-15	04/21/2010
944-80-55-7	Superseded	2010-15	04/21/2010
944-80-65-1	Added	2010-15	04/21/2010

The amendments in this Update were adopted by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
Thomas J. Linsmeier
Leslie F. Seidman
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force consensus when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force or Board members gave greater weight to some factors than to others.

Background Information

BC2. The Task Force was asked to address practice questions about whether an insurance entity should be required to consolidate a majority-owned investment when ownership is held through the insurer's separate account or through a combination of investments in the insurer's separate and general accounts. At the September 9–10, 2009 EITF meeting, the Task Force reached a consensus-for-exposure on EITF Issue No. 09-B, "Consideration of an Insurer's Accounting for Majority-Owned Investments When the Ownership Is through a Separate Account." A proposed Accounting Standards Update (proposed Update) was issued on September 30, 2009, with a comment period that ended on October 26, 2009. Four comment letters were received from respondents to the proposed Update.

BC3. Based on a request made by a few respondents, the Task Force decided to broaden the scope of the amendments in this Update to include all investment funds in which separate accounts may be involved. The Task Force concluded that because similar consolidation issues could arise if the investment fund is deemed a variable interest entity under Subtopic 810-10, it would be appropriate to broaden the scope of the amendments to include investment funds considered to be variable interest entities. The Task Force also concluded that the underlying principle of whether an insurance entity should consider separate account interests held for the benefit of policy holders in the insurer's consolidation assessment equally applies to both voting-interest entities and variable interest entities.

BC4. The Task Force concluded that for the purpose of evaluating the retention of specialized accounting for investments in consolidation as described in paragraph 810-10-25-15, a separate account arrangement should be considered a subsidiary. In the view of the Task Force, specialized industry accounting that applies to investment companies and that is retained in consolidation by non-investment-company parents in accordance with paragraph 810-10-25-15 should apply to separate account arrangements that meet the definition of an investment company in Topic 946. Therefore, the Task Force concluded that an insurer is not required to consolidate an investment in which a separate account holds a controlling financial interest if the investment is not or would not be consolidated in the standalone financial statements of the separate account.

BC5. Paragraph 944-80-25-3 as amended requires an insurer to consider in its consolidation analysis a separate account interest held for the benefit of a policy holder if the policy holder is a related party. The Task Force observed that this guidance is necessary because the consolidation guidance in Subtopic 810-10 on variable interest entities requires the consideration of related party interests in certain circumstances. Consolidation guidance in Subtopic 810-10 on voting interest entities does not require consideration of related party interests and the amendments in this Update do not change that guidance.

BC6. The Task Force noted that although the insurer may legally hold a controlling interest in an investment through its management of the separate accounts, it did not believe that consolidation of those investments appropriately portrayed the economics of the relationship or that consolidating the investment would provide useful information for financial statement users. The Task Force also believes that consolidation would unnecessarily increase the complexity of an insurer's financial statements.

BC7. The Task Force also addressed respondents' requests to provide additional guidance on how an insurer should consolidate an investment fund in situations in which the insurer concludes that consolidation is required.

BC8. The Task Force concluded that the insurer should consolidate the investment fund by including the portion of the fund assets representing the contract holder's interests as separate account assets and liabilities in accordance with paragraph 944-80-25-3, and the remaining portion of the fund assets (including the portion owned by any other investors) in the general account of the insurer on a line-by-line basis. Noncontrolling interests should not be included in the separate account liability but rather classified as a liability or equity based on other applicable guidance. The Task Force believes that general GAAP guidance on how to present noncontrolling interests also should apply to investments held by a separate account that the insurer consolidates.

Transition and Effective Date

BC9. The Task Force believes that the effective date of the amendments in this Update provides preparers with sufficient time to implement the requirements. Additionally, the Task Force believes that retrospective application to all prior periods on the date of adoption provides users with the benefits of consistency and comparability between all periods.

Benefits and Costs

BC10. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC11. The Task Force believes that the amendments in this Update provide (a) clarity on the application of the consolidation guidance when separate accounts are involved and (b) meaningful information to users. The Task Force does not believe the amendments will result in significant costs because it believes that consolidation of investments by insurers in these situations has been limited in practice.

Amendments to the XBRL Taxonomy

There are no proposed amendments to the XBRL taxonomy as a result of the amendments in this Update.