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Mr. Robert H. Herz Chair Financial Accounting Standards Board 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference EITF090G

Dear Mr. Herz:

The American Council of Life Insurers (ACLI)¹ appreciates the opportunity to share with you our views regarding Proposed Accounting Standards Update—Topic 944: Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts EITF 09-G, Clarification of the Definition of Deferred Acquisition Costs of Insurance Entities (the "EITF"). The ACLI remains deeply concerned with the development of this EITF and the need to revise the current U.S. GAAP accounting for insurers' deferred acquisition costs (DAC) given the fundamental changes to DAC that the Boards are considering as part of their joint project on insurance contracts. Below we offer our general comments in response to the proposed EITF and provide specific feedback relative to the questions posed to respondents in the EITF.

## **General Comments**

We have significant reservations about timing of the Board's effort through this proposal to address the accounting for DAC in such close proximity to a complete overhaul of the accounting for insurance contracts. We do not agree with the FASB that the implementation of this EITF for the short period of time prior to the implementation of a new insurance contracts standard, which will likely provide a different solution for DAC than in this proposal and which will converge with IFRS, would provide enough benefit to justify the added cost of implementation. An effective date beginning with fiscal years after December 2010 will be closely followed with major changes to the measurement of insurance contracts resulting from the expected completion of the insurance standard planned for 2011. While the final insurance contracts standard is expected to be effective in 2014, our understanding is that the implementation of the standard would require retroactive restatement back to 2011 in many cases to show three comparative periods at the effective date. As a result, insurance companies will begin the process of implementing the insurance contracts standard once it is finalized, which is expected to occur at the end of 2010 or early 2011. Given the timing overlap between these standards, companies will struggle to meet the competing demands for implementing this interim proposal and the insurance contracts standard. We believe that any reconsideration of the concepts brought forth in this EITF should

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<sup>&</sup>lt;sup>1</sup> The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S life insurance and annuity industry.

be done so within the joint insurance contracts project rather than issuing an interim, temporary US GAAP standard which is not convergent with IFRS.

We believe that the changes proposed in the EITF could significantly impact the current accounting for DAC by narrowing the definition of costs that qualify for deferral. The proposed definition, "directly related to the successful acquisition" is narrower than the current definition of "vary with and are primarily related to", thereby causing a significant change in accounting practice for the life insurance industry, for which we do not believe provides a benefit that would justify its cost of implementation or increase the decision usefulness of the financial statements. It is our contention that the current capitalization model is working effectively and furthermore, we believe that the current capitalization model should be preferred because it preserves the matching principle and consistency of financial statements under US GAAP. The upfront costs that are deferred are recouped through fees and revenue received from the customer over time. Similar to a manufacturing facility that capitalizes the costs it incurs to get its business ready for its intended use, these costs are necessary in order to bring revenue to the insurance company. The proposed model would result in a mismatch of revenue and expense and, if adopted prospectively, cause inconsistency between periods within insurers' financial statements and, ultimately, user confusion. On a relative basis, the current capitalization model results in a larger DAC asset than under the proposed model. The current DAC asset, while larger, must be supported to be recorded and to remain on the balance sheet. US GAAP contains safeguards such as those in subtopic 944-30-30, to prohibit a company from deferring acquisition costs if there are not enough gross premiums to cover the cost and in subtopic 944-60-30, to subject the asset to recoverability testing.

As stated in the proposed guidance, the Board is issuing this guidance to address diversity in practice. We do not believe current diversity in practice is significant enough to warrant the cost of implementing an interim standard. It is incumbent upon companies to establish capitalization policies which can be supported within the current guidance, and given that US GAAP guidance has been in place for a number of years, we believe these capitalization policies have been well vetted. In accordance with current guidance, companies make decisions regarding the costs to defer based on how the expense is tied to the acquisition of new business rather than simply the type of expense. While there may be diversity in practice, we believe that the difference among companies for treatment of certain expenses results from differences in how companies acquire business rather than driven from any flaw in the US GAAP accounting model. A narrower definition will not eliminate diversity in practice due to differences among companies that will inevitably result from different interpretations, different business models, and the need for managements to exercise their judgment.

## Response to Questions for Respondents

Question 1: The amendments in this proposed Update would revise the definition of an acquisition cost of an insurance entity to be costs that are directly related to the acquisition of new and renewal contracts and include those costs that are (1) incremental direct costs of contract acquisition and (2) directly related to specific activities performed by the insurer for the contract.

- a. Do you agree with this conclusion? If not, what criteria do you think should be used as the basis for capitalization of acquisition-related costs?
- b. Is the proposed guidance operational or is further guidance necessary to implement the proposed guidance?

## Response:

a. We disagree with a narrowed definition of capitalizable costs as outlined in the section above. Furthermore, the implementation guidance (update to subtopic 944-30-55-1) provided in the EITF is too rules-based rather than principles-based and does not allow for entities to consider the facts and circumstances of their acquisition process relative to the principles provided in the guidance to make the determination of which costs should be deferred. The existing criteria, "varies with and primarily related to", has been an operational and effective basis for capitalization of acquisition costs because it

appropriately allows for companies to apply a principle that captures the costs they incur to acquire business for which they will receive a future revenue stream.

b. We do not find the proposed guidance to be operational as more clarification is needed for the reasons stated above. Additionally, we have concern with both the retrospective and prospective transitions to the new standard. DAC on long-duration insurance contracts is amortized over the life of the contract, often 20 years or more, which results in large DAC balances with significant history. Historical records for successful efforts and other proposed definitional changes do not exist for many companies, thereby making the retrospective adoption either not an available approach or based on high-level estimates rather than actual data. A prospective application also causes concern because the financial statements of life insurance companies will become less useful. Prior deferrals would continue to amortize at historical levels while smaller, current period amounts would be deferred based on the definition change. This mixing of accounting models will lead to user confusion and ultimately a request for non-GAAP comparable information.

Question 2: Do you agree that for a cost to meet the definition of a deferred acquisition cost, it must relate to successful efforts (that is, a new or renewal contract)?

Response: We disagree with the EITF that in order for a cost to meet the definition of DAC it must relate to successful efforts. Insurance entities consider the entire cost, successful and unsuccessful, related to the generation of business as an acquisition cost because the entire costs are incurred in order to acquire the business. For example, a company needs an underwriting department of a certain size to handle a certain level of volume of contracts (both successful and unsuccessful). Some of the contracts will be acquired but others will not. The entire underwriting department is needed to support the contracts that end up on the company's books. Furthermore, insurance companies explicitly price the products based on the entire expected costs incurred for both successful and unsuccessful activities related to acquiring contracts and receives that compensation over the life of the contract. The deferral and amortization of acquisition cost provides a better matching to the revenue pattern.

Question 3: Do you agree with the amendments in this proposed update that specify that advertising costs incurred by insurance entities should not be included as part of deferred acquisition costs, but, rather, should follow the guidance for advertising?

Response: We feel that direct response advertising costs in the insurance industry are acquisition costs and are typically incurred in lieu of agent commissions. We agree that subtopic 340-20 should be applied to this business, but it would be more appropriate for these costs to be reported as deferred acquisition costs. It is our understanding that this EITF is in part due to questions asked by the SEC related to advertising costs that are included in DAC noting diversity in practice. In our September 1, 2009 letter, we responded to specific questions about the insurance industry's practice regarding advertising costs stating that generally these costs are expensed. There are a few situations, however, where advertising costs could be capitalized and we provided some examples. Our conclusion was that general marketing costs are expensed as incurred while certain advertising costs that vary with and primarily relate to the acquisition of new and renewal insurance contracts may be appropriately included in an insurance company's DAC calculation. In other words, the decision on what costs are deferred is not simply made based on the type of expense but rather how the expense is tied to the acquisition of new business.

Question 4: Do you expect to incur significant costs as a result of the amendments in this proposed Update? If so, please be specific about the nature of the costs you expect to incur.

Response: We believe that the definitional changes in the EITF for costs that qualify as DAC are substantial compared to current practice and would result in insurance entities incurring significant implementation costs. Most insurance companies' systems are not equipped to capture costs in a manner that would isolate successful efforts from unsuccessful efforts. Changes to existing systems

would be costly, and as we have discussed above, we believe that these changes would add little benefit to the financial statements.

Question 5: Do you believe that the proposed effective date is operational? Please provide the reasons for your review.

Response: As stated in our general comments provided above, we believe that the proposed effective date of years beginning after December 15, 2010 is not operational given its proximity to the implementation of the forthcoming insurance contracts standard and based upon the extensive system changes that would be required. This is especially the case for companies that would prefer to choose retrospective adoption of this guidance. While the final insurance contracts standard is expected to be effective in 2014, our understanding is that the implementation of the standard would require retroactive restatement back to 2011 in many cases to show three comparative periods at the effective date. As a result, insurance companies will begin the process of implementing the insurance contracts standard once it is finalized, which is expected to occur at the end of 2010 or early 2011. Given the timing overlap between these standards, companies will struggle to meet the competing demands for implementing this interim proposal and the insurance contracts standard. As such, we believe that the analysis begun in this project should be redirected toward the insurance contracts standard and reconsidered as part of that final project.

If the Board issues the EITF as written despite the concerns expressed in this letter, we believe that the effective date should be deferred for one year (to years beginning after December 15, 2011) to allow companies time to revise their existing infrastructure deferring acquisition costs. Issuance of this EITF in mid 2010 with a 2011 effective date would provide little time for companies to allocate the resources needed to make extensive system changes and/or create new manual processes, including systematically distinguishing between successful and unsuccessful expenditures for each type of spending. Given the significance of acquisition costs to insurance companies' financial statements, more time would be needed to establish internal controls over the new processes and procedures.

## Conclusion

We appreciate the Board's effort to address concerns regarding the scope of costs deferred in connection with the acquisition of insurance contracts. The significant changes proposed in this EITF need to be further discussed and analyzed, and the joint project on insurance contracts standard would be an appropriate forum for these discussions. The Board should avoid non-convergent interim standards and focus its effort on developing a converged standard with the IASB which will undergo field testing and roundtable discussions in order for the Boards to fully appreciate the implications of the changes proposed. We appreciate the opportunity to offer our feedback on this issue and would welcome the opportunity to discuss our views with the EITF and the Board.

Sincerely,

Michael Monahan

Director, Accounting Policy

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