October 23, 2013

Financial Accounting Standards Board
401 Merritt 7
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RE: File Reference No. 2013-290

Members of the Board:

Pacific Life Insurance Company appreciates the opportunity to comment on the Financial Accounting Standards Board’s (FASB) Proposed Accounting Standards Update Insurance Contracts (ASU). We support the FASB’s efforts to establish and improve standards of financial accounting principles generally accepted in the United States of America (U.S. GAAP). However, as these proposed changes to accounting and reporting for insurance contracts will have a profound impact on our insurance businesses, we have several significant concerns as described below.

Pacific Life Insurance Company has actively participated in the drafting of responses to the ASU by the American Council of Life Insurers (ACLI), and we support the views and comments expressed in the ACLI’s response.

Lack of Convergence

We support the FASB’s and the International Accounting Standards Board’s (IASB) objective of developing a single set of high quality global accounting standards for insurance contracts that are relevant, understandable and provide financial statement users with the ability to make informed decisions. We are troubled that the current proposals provided by the Boards continue to contain significantly divergent views. We believe these differences between the FASB’s and IASB’s current proposals for insurance contracts will obstruct the ultimate goal of providing comparability across similar entities, jurisdictions and capital markets. We believe that because of the similarities in the FASB and IASB insurance standards, the current ASU, if finalized, may be utilized by many analysts to compare financial results of domestic insurers to international insurers although very material financial statement differences will emerge between the two insurance standards and the earnings profiles of comparable companies may illustrate different periodic earnings based on the divergence between the proposed standards. Differing views among the FASB and IASB on critical components of the accounting models require resolution prior to issuance of a final standard. These major differences include margin approach, measurement (including “unlocking” differences and acquisition costs), subsequent measurement and portfolio definition.

We urge the FASB and IASB to reconcile their accounting models prior to issuance of a final standard. Assuming the Boards move forward as proposed with divergent models, we could
envision through the passage of time ultimate convergence will be requested by markets and financial statement users based on the inability to compare companies, or the inability to understand the implication of presumed subtle differences between the two accounting models. If such ultimate convergence to a single set of global accounting standards for insurance contracts does occur after the implementation of the proposed changes in the ASU, a company’s financial models would need to be modified for a second time upon convergence with IASB specific to accounting for insurance contracts and/or the possible conversion to International Financial Reporting Standards. The potential adoption of multiple models will come with an additional round of significant costs and use of resources. Implementation of a new standard for insurance contracts under the current ASU carries significant direct and indirect costs (including system modifications on legacy systems related to products sold 30+ years ago) and the commitment of resources which would be wasted if convergence ultimately occurs.

Portfolio Definition

In addition to believing that convergence is necessary for meaningful international comparison, we believe that the IASB’s definition of a Portfolio, which provides that a Portfolio be defined as insurance contracts managed together as a single pool, is more manageable in ensuring comparability between life insurance entities than the FASB guidance of similar duration and similar expected release of the single margin. In addition, the FASB guidance on similar risks is not defined and could lead to significantly different interpretations and results.

Discount Rates

Rather than the Top Down or Bottom Up approach, we believe the discount rates should be based on the expected return on the actual assets backing the liabilities for life insurance products or a reference portfolio with a similar duration as the liabilities. This is consistent with the economics of the business including pricing practices and reflects the most likely outcome of the insurance activity considering underwriting and asset and liability matching of investments due to the long term nature of the life insurance products.

Unlocking

We support the incorporation of an unlocking mechanism into the final pronouncement for differences between current and previous estimates of cash flows relating to insurance coverage and other services. The measurement of the insurance contract liability would not provide a meaningful representation of the unearned profit to be recognized over the remaining coverage period if the margin is not adjusted to reflect changes in estimates made after contract inception.

An unlocking mechanism better reflects the economics of the life insurance industry and the long term nature of its various products. Recognizing an immediate profit or loss for expected changes in future profits is not a meaningful representation of the long term nature of the industry and is inconsistent with the traditional matching principles reflected in existing U.S. GAAP. Additionally, the current FASB proposal presents an inconsistency by prohibiting the recognition of gains at initial recognition, but then requiring the subsequent recognition of gains on the basis of changes in estimates made immediately following initial recognition.

We support the complete retrospective unlocking as currently contemplated in the Accounting Standards Codification’s Topic 944 – Financial Services – Insurance.
Further, again we encourage the FASB and the IASB to fully converge on this issue as failure to do so will result in materially different earnings patterns that will diminish comparability and make it difficult for the users of the financial statements to fully understand the economics of our business.

Transition

We respectfully request an alternative implementation method to the application of a full retrospective method at adoption. There would be major cost savings to utilize the Building Block Approach (BBA) on the implementation date using then current assumptions to calculate the margin. We estimate that the current ASU requirements on transition would significantly increase implementation costs for the life insurance companies with no clear benefit or increase in accuracy. The retrospective approach proposed will allow entities to use a practical expedient for measurement of portfolios of insurance contracts. However, with legacy systems, and significantly aged policies, all of the data necessary to apply the standard may not be available.

Cost

We estimate our out of pocket costs to implement the ASU at multiple $ millions, excluding internal lost opportunity costs. We believe these costs to be excessive for an accounting standard not converged internationally and we do not believe there is a real justification for expending such amounts that do not benefit policyholders.

Effective Date

The ASU, if finalized without addressing the complexities noted herein and in the ACLI response, represents a major change to the accounting for virtually all products that a life insurance company sells. In addition, it would be expected that the final accounting guidance will include revisions from the ASU that will also have to be evaluated. Since current financial reporting practices for public and many private companies is to present three years comparative income statements and as such two sets of “books” will be required for the first two years of presentation, and as a result, the transition to the new basis of accounting for insurance contracts will require even greater system and personnel resources.

We strongly believe that if the final standard is issued in late 2014 or early 2015 that the implementation date be no earlier than the year ended 2019. Retrospective adoption would then require implementation of the final pronouncement in 2017 and 2018. A final standard in early 2015 at the latest would allow less than 2 years to prepare for record keeping on two bases of accounting. In fact, a 2019 effective date would require substantial additional resources from life insurance companies to ensure fair presentation in the financial statements.

Financial Instruments

In April 2013, the FASB provided the opportunity to comment on the Proposed Accounting Standards Updates, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities—Proposed Amendments to the FASB Accounting Standards Codification. There is an integral relationship between a life insurer’s investments in financial instruments and the financial resources available to support its insurance obligations. In order to assure that the eventual accounting and financial reporting model is representative of the economics of the life insurance industry, we strongly suggest that any
implementation of significant change in accounting for financial instruments be aligned to that of the new insurance contracts proposal.

Reissuance of an Exposure Draft

We urge the FASB to reissue the ASU if major changes are made to the current proposal to ensure that significant modifications and changes are addressed in a public forum.

Conclusion

We thank the FASB for providing the opportunity to comment on the new accounting proposal for insurance contracts. We recognize that important steps forward in developing a single set of high quality global accounting standards for insurance contracts have been made. However, several material differences between the FASB and IASB proposals still exist. In an effort to create comparability across similar entities, jurisdictions and capital markets, while improving decision useful transparent financial statements, a final converged proposal will be essential. Adopting U.S. guidance at this time that appears similar to international standards, yet yields materially different results is not in the best of interest of the financial statement users and is an unwarranted expense for insurance companies.

Existing U.S. GAAP with respect to insurance contracts is robust and well understood by investors, analyst and various other users of the financial statements. Current guidance has resulted in an accounting model for insurance contracts that continues to provide relevant information that provides users with the ability to make informed decisions. In an effort to enhance transparency and usefulness, improvements could be made through additional disclosure practices of current U.S. GAAP, as opposed to an entirely new model for insurers. This approach appears entirely reasonable and economically prudent pending full convergence in accounting for insurance contracts.

Sincerely,

Edward R. Byrd
Senior Vice President and
Chief Accounting Officer

cc: Adrian S. Griggs
    Executive Vice President and
    Chief Financial Officer