Life Insurer Comments on Field Testing of FASB Proposed Accounting Standards Update on Targeted Improvements to the Accounting for Long-Duration Contracts

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Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board ("FASB" or the "Board")
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

Re: Field Testing of the Targeted Improvements by the FASB – Long-duration Contracts

Dear Ms. Cosper:

We continue to be fully committed to helping the Board achieve the goal of a high-quality accounting standard. As a result, we have spent significant time and effort to complete Field Testing of the FASB Proposed Accounting Standards Update (herein referred to as targeted improvements) to the accounting for long-duration contracts. With the assistance of a third-party consultant, we performed Field Testing to cover a wide range of products and several possible economic scenarios. The results of our Field Testing, along with key findings and observations, are the subject of this document.

In this document, we do not provide comments on all aspects of the targeted improvements, but instead, we focus on areas where we encountered uncertainty interpreting the guidance, challenges applying it, or outcomes that were not reflective of our expectations or the underlying economics of the business. Four of the major areas of concern are:

• Participating contracts
• Definition of non-participating discount rate
• Retrospective vs. prospective unlocking
• Market risk benefits (including impact of transition)

In order to publish this document on a timely basis, we focused our efforts on completing and analyzing our field test results. As such, we made a number of simplifying assumptions and have not yet fully developed all possible solutions to the issues identified. We concluded that while many of the principles underlying the targeted improvements are sound, there were conceptual concerns and unintended consequences not reflective of the economics once the details were reviewed.

Our executive summary provides key findings and observations from the Field Testing and the recommendations or alternatives for the FASB to consider before finalizing the standard. In certain areas, we have not concluded on a recommendation or alternative proposal, but with due consideration, alternatives could be established.
We once again thank you for the opportunity to respond to your proposed Accounting Standards Update (ASU), Targeted Improvements to the Accounting for Long-Duration Contracts, and for your consideration of our key findings, observations, and recommendations. If you have any questions or would like to meet with us regarding the contents of this letter, either individually or as a group, please do not hesitate to contact us.

Very truly yours,

Lynda Sullivan
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Peter M. Carlson
Executive Vice President and Chief Accounting Officer
MetLife, Inc.

Robert M. Gardner
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1. Executive Summary

The four companies who performed this Field Testing, Manulife, Metropolitan Life, New York Life, and Prudential Financial (collectively referred to as the Group, we, or us), together reported aggregate total assets and equity of $2.4 trillion and $174 billion, respectively, as of December 31, 2015.\(^1\) In the United States alone, the Group held $1.6 trillion of total statutory admitted assets as of December 31, 2015, which accounted for approximately 25% of the total net admitted assets in the United States life insurance industry.

Our Field Testing included nine different products,\(^2\) grouped into four segments that represent the most common products in force in the United States. Our Field Testing was based on actual experience between 2007 and 2012, a period of significant volatility in both interest rates and stock market performance. The goal of the Field Testing was to examine whether the proposed targeted improvements produce financial results that reasonably represent performance during that period.

We commend the Financial Accounting Standards Board (FASB or the Board) on addressing user concerns through the targeted improvements with current long-duration insurance accounting. While not all of the Group members view all of the targeted improvements to be a necessary change and some would prefer for certain of the changes not to be made, the objective herein is to address the potential impacts if the targeted improvements are adopted as currently stated. The following targeted improvements are considered by the Group to be particularly helpful:

- Simplifying the amortization of Deferred Acquisition Costs (DAC);
- Using Other Comprehensive Income (OCI) to reflect any required updates in current discount rate assumptions for traditional life and annuity contracts; and
- Allowing alternative methods to implement the transition to the new accounting;

Several other targeted improvements cause concern and warrant further discussion. We cover certain topics in more detail below:

- Participating contracts
- Definition of non-participating discount rate
- Retrospective vs. prospective unlocking
- Market risk benefits (including impact of transition)

Other less critical topics are included as well.

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\(^1\) [http://www.snl.com/](http://www.snl.com/)

\(^2\) Including two different variable annuities
Participating Contracts

Notwithstanding the merits of applying the targeted improvements for unlocking assumptions and using current discount rates on non-participating contracts, due to the nature of participating contracts, certain modifications are required to the targeted improvements. These modifications include:

- Establish a discount rate for the balance sheet that reflects the economics of the contract and is consistent with the current and projected market rates underlying the dividend credited rate. To the extent that the discount rate(s) used to discount cash flows is not consistent with the dividend credited rate, then the discount rate is inconsistent with the characteristics of the liability. This is a fundamental mismatch contradicting the general principles set out in Concept 7: Using Cash Flow Information and Present Value in Accounting Measurements; specifically, paragraph 41b. See Section 5. Alternatively, the projected dividends should be consistent with the assumption that new investments and reinvestments are made at the required discount rate.

- When determining net income, the interest accretion rate and the dividend credited rate used for projecting future cash flows need to be internally consistent. If a current dividend credited rate is used to determine the projected cash flows, then the interest accretion rate needs to be updated as well. To do otherwise would be conceptually equivalent to valuing a floating-rate bond by discounting the floating-rate cash flows at a locked-in discount rate, misrepresenting the floating-rate nature of the contract. We recommend correcting this mismatch by using a “level-spread” approach. Under a level-spread approach, net income is not based on a single interest accretion rate but rather on a set of interest accretion rates that vary by duration in parallel with projected dividend credited rates at each duration.

- When interest rates change, there should be consistent treatment of the resulting impacts within the liability valuation for the following items: (a) the impact of the change in dividend credited rates on projected cash flows and (b) the impact of updating the discount rate. The targeted improvements would unlock the net premium ratio for (a) but not for (b), creating an internal inconsistency within the valuation. Either the changes in cash flows resulting from dividend credited rate changes should be excluded from the change in net premium ratio (consistent with the International Accounting Standards Board (IASB) approach for unlocking the contractual service margin) or the impact of the updated interest accretion rate (per the second bullet above) should be included in the change in net premium ratio.

- Expected policyholder dividends should exclude any projected future dividends arising from profits from other businesses. These additional dividends should be accrued as declared, similar to the way stock companies record shareholder dividends.

Closed Block

For participating contracts within closed blocks formed upon demutualization, the amount paid to policyholders is equal to the amount of assets in the closed block as required by regulation, plus the amount of any asset deficiency related to underlying guarantees. Applying the targeted improvements, even assuming the approach for participating contracts is adapted to address the issues noted above, would not be worth the cost of performing these calculations.

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3 For participating contracts previously accounted for under FAS 120 but now accounted for under ASC 944.
A simpler, yet more accurate, depiction of the insurer’s obligation would be achieved by the following two alternatives:

**Alternative #1:**
- Set the base closed block liability equal to the asset value,\(^4\) and
- Require an additional liability, either using Statement of Position (SOP) 03-1\(^5\) or fair value methodology, if and when the assets are projected to become deficient due to contractual guarantees. (Note: based on methodologies used to establish the closed block assets, the need for such a liability is likely to be rare.)
- If the Board is concerned about the value of closed block liabilities after demutualization (or upon transition) differing from the pre-demutualization (or pre-transition) value, this can be addressed by an additional accrual. This accrual would initially equal the difference between all policy liabilities (including policyholder dividend obligations and terminal dividend liabilities) immediately prior to demutualization or transition and the liability calculated above. This accrual would be amortized over time consistent with the Board’s decisions on DAC amortization. It is our view, however, that such differences are inevitable for both demutualizations and for this accounting transition. Since they are one-time events, they are best handled by a disclosure of the amount at the time they are recognized rather than a continuing adjustment to the balance sheet.

**Alternative #2:**
- Apply the fair value option to the closed block assets and liabilities. Election should be made at transition for existing closed blocks or at demutualization.

If our recommendations for participating contracts are rejected, participating contracts should be excluded from the scope of targeted improvements and preparers should continue to use existing guidance to calculate the liability.

**Definition of Non-Participating Discount Rate**

Under the targeted improvements, cash flows for traditional contracts would be discounted at a “high-quality fixed-income instrument yield.” This language has been interpreted as referring to AA rated investments in other areas of existing US GAAP. Notwithstanding our concerns about the discount rate for participating contracts discussed above, we are concerned that a AA rate does not provide an adequate illiquidity premium for non-participating contracts.

Our experience during the 2008 financial crisis suggests that spreads between AA and A rated investments can move significantly. We are concerned that in such markets this impact could lead to a large decrease in US GAAP equity or even negative equity. This would be a false signal to investors and perhaps more importantly to regulators who may use US GAAP financial statements as a measure of insurance company solvency. The typical investment portfolio of insurers backing non-participating traditional contracts is roughly at an A rating. This indicates that the appropriate illiquidity premium for such contracts is closer to an A rating.

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\(^4\) This alternative can be applied with or without requiring the reporting of the assets at fair value, as long as the liability value is set equal to the asset value. But setting the assets to fair value may be preferable since otherwise the liability value would be based on a mixture of measurement attributes.

\(^5\) Accounting under ASC 944 previously contained in Statement of Position 03-1: Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts.
We therefore recommend changing the language describing the discount rate and/or providing application guidance such that the discount rate used for traditional insurance contracts would represent an A yield for USD denominated liabilities. Alternatively, an appropriate discount rate could be based on an average of investment grade yields or NAIC\(^6\) 1 and NAIC 2 yields, or an average of investment grade yields, similar to the proposal currently exposed by the NAIC\(^7\) for discounting single premium immediate annuities.\(^8\)

**Retrospective vs. Prospective Unlocking**

Under the targeted improvements, the net premium ratio is unlocked from issue when projected cash flow assumptions change (referred to as the “retrospective method”). Along with this retrospective method, our Field Testing also included the development of results based on the prospective method of determining and applying the net premium and deferred profit liability (DPL) amortization ratios.

The results for the retrospective and prospective methods were generally similar. The retrospective method defers a portion of the variances that emerge between actual results and previous best estimates, while the prospective method defers more of the impact of changes in estimates related to future activity. We recognize that as the in-force blocks of business age, these differences between the results produced by these methods would become more pronounced.

The prospective method would be easier to implement and execute from an operational perspective, since the actuarial systems do not need to maintain a detailed history of past experience. The retrospective method would be far more costly to implement due to required changes to actuarial systems and data storage needs. It is also more intuitive to fully reflect variances when actual activity differs from previous estimates in net income, while changes in previous estimates about future activity should generally not impact net income until the actual activity materializes. The prospective unlocking methodology accomplishes these objectives.

At transition, there is a strong possibility that it may be impracticable to apply the guidance retrospectively for significant blocks of business due to the lack of available historical data. In such circumstances, the prospective method would provide more consistent treatment between “in force at transition” and new business after the transition period.

**Market Risk Benefits**

We agree with the targeted improvements to report the impact of changes in the instrument-specific credit risk through OCI rather than net income. This avoids volatility from changes in instrument-specific credit risk distorting the net income.

While the remaining volatility from reporting all market risk benefits at fair value can arguably be considered economic volatility, the Board should consider excluding death benefits from the targeted improvements on market risk benefits. Market value is less relevant for these benefits since death benefits are not payable unless the insured dies. Therefore, the risk of having to

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\(^6\) National Association of Insurance Commissioners (NAIC), the standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states.

\(^7\) The exposure is available at http://www.naic.org/documents/committees_a_laf_v22sg_160719_draft_clean.pdf (link as of 10/27/2016).

\(^8\) The Portfolio Credit Quality Distribution is the rate currently proposed as 5% treasuries, 15% Aa, 40% A, and 40% Baa.
pay out in adverse market conditions is mitigated. This would retain SOP 03-1 accounting for death benefits but improve the accounting consistency of living benefits because all living benefits that meet the criteria of a market risk benefit would be reported at fair value. It should be noted that GMDBs are currently accounted for consistently in the industry.

Deferred Acquisition Costs

We acknowledge that the targeted improvements that establish one consistent DAC amortization model for all long-duration contracts (except certain investment contracts) go a long way toward reducing complexity and improving user understandability. We are, however, somewhat concerned about the decision to eliminate the premium deficiency/loss recognition requirements by simply changing the fundamental rationale behind what the DAC asset is deemed to represent and how it should be viewed, or not viewed, from an impairment perspective.

It is important to note that the DAC premium deficiency test under the existing guidance is two-pronged. It is first an asset recoverability test and then, after the asset is fully charged off, becomes a liability adequacy test (given there are no more DAC assets associated with these contracts). This is an integrated test, since on Day 1, the asset is deemed deferrable only because it is recoverable from profits inherent in the contracts acquired. The updating of reserve assumptions in targeted improvements appears to have eliminated the need for the liability adequacy test portion of the current test; however, it does not seem to acknowledge that although there may be a liability reported using current assumptions, there could be an asset that is no longer fully recoverable, as it was required to be at inception to be deferrable in the first place.

To address these concerns, we recommend that that Board strongly consider incorporating a mechanism in the model to avoid DAC balances that are not recoverable from the profits of the acquired contracts. In Section 3.4.4, we provide a recommendation to address this issue for traditional long-duration contracts without requiring an explicit impairment test. We are open to discussion of solutions for nontraditional contracts.

Transition

Market Risk Benefits

Measuring the attributed fee for in-force contracts at transition may generally be considered impracticable as developing assumptions as of the contract issuance date is probably not possible without the use of hindsight. As such the Board should consider a transition method that requires an approach to calculating the attributed fee at transition consistent with the approach used for DAC and the simplified approach used for Financial Accounting Standard (FAS) 60. That is, the attributed fee should be calibrated at transition such that the fair value of the market risk benefit, i.e., the benefits net of attributed fees, does not result in a change to the liability at transition. This would also avoid potentially dramatic changes to insurer GAAP equity, as well as subsequent reversal of those changes in equity through net income, which may not be well understood by investors and regulators.
Closed Block

As noted above, we do not see a benefit of implementing the targeted improvements to the closed block because all assets will, ultimately, be passed through to the policyholders within the closed block. We ask that the transition treatment be consistent with the approaches described above if ultimately adopted.

Additional Observations

One conclusion we reached from our Field Testing is that the targeted improvements, while indeed targeted, are nevertheless a significant change to the accounting for long-duration contracts. We were unable to test several of the targeted improvements because the necessary information was not available from our current systems and is unlikely to be available for any of us without major system changes. Even when the information is available, the companies are likely to require no less than four years to implement the proposed changes. In some cases, the cost of implementation could exceed the perceived benefit of the change.

The targeted improvements represent fundamental changes that involve many recognition and measurement principles that have never been applied in practice, including annual assumption updates, retrospective unlocking of the net premium ratio, OCI reporting for discount rate changes and instrument-specific credit risk, and DAC amortization based on the amount of undiscounted insurance in force. As such, implementation would be a major undertaking for almost all preparers (large or small) and their auditors; not to mention analysts, investors, regulators, and rating agencies, who would need to be re-educated to be able to fully understand the impacts to insurers’ financial statements.

Given the widespread fundamental changes the targeted improvements represent, the Board should strongly consider establishing a Transition Resources Group (TRG) to address potential diversity in interpretation and other practice issues prior to the issuance of a final standard. The TRG, if composed of members of the preparer, actuarial, auditor, investor, and regulatory communities, can be a powerful tool to avoid potential future amendments to the final standard, effective date deferrals, and, most important, comparability issues, ultimately impacting financial statement users.
2. Introduction

On October 11, 2013, we issued a comment letter, supported by our Field Testing, to the FASB in response to their June 27, 2013, exposure draft on the accounting for insurance contracts. Since the 2013 exposure draft, the FASB has moved away from the building block approach and, instead, decided to make focused targeted changes to certain aspects of accounting for insurance contracts as currently required under Accounting Standards Codification (ASC) 944, Financial Services – Insurance (ASC 944 or the "existing guidance"). On September 29, 2016, the FASB issued an exposure draft with the Proposed Accounting Standards Update (herein referred to as "the targeted improvements") to the existing guidance.

The objective of this comment letter ("this Comment Letter") is to provide the Board with our updated Field Testing, which analyzes the impact of the targeted improvements when compared to the existing guidance. Our observations of the results and certain other aspects of the targeted improvements are also noted within individual sections of this Comment Letter.

The Field Testing project remains a joint effort of the same four global financial services companies with leading life insurance operations in the United States, Canada, Asia, Europe, and Latin America that performed the Field Testing during 2013. Together, our product offerings include individual and group life and health insurance, property and casualty insurance, participating and non-participating contracts, and annuities. The companies in the Group have had substantial experience preparing financial statements under US GAAP.

We remain fully committed to assisting the FASB to achieve its goal of developing a high-quality accounting standard. We have spent significant time and effort performing the Field Testing, utilizing many actuaries and accountants over a period of more than six months. The significant time and effort required to perform the Field Testing alone should be considered in relation to this Comment Letter. This is also indicative of the importance that we place on ensuring a high-quality final standard that achieves the desired objectives set by the Board while remaining operational.

We engaged a third-party consultant ("the consultant") to collect and review the data necessary to perform the Field Testing, and to do so in a manner that would preserve the confidentiality of each Group member’s competitive information. To replicate the level of aggregation expected for actual financial reporting and to preserve the confidentiality of each Group member’s individual product data (both from each other and the public), the consultant scaled and combined the data received from the Group members, ultimately presenting it under four operating segments prior to releasing to the Group.

We focused our efforts on assessing the targeted improvements and have applied certain simplifying assumptions and practical expedients in order to provide the results of the Field Testing in a timely manner.

Nine product lines were selected for our testing and are considered to be representative of typical products written by life insurance companies in North America. All tested products represent long-duration contracts. We tested these products over the Study Period defined as December 2007 to December 2012. We have not tested reinsurance.
3. Targeted Improvements Overview and Observations

In this section, we discuss existing guidance, the targeted improvements, the Field Testing approach, and our resulting observations. For the Field Testing, we reflect the impacts of the targeted improvements in the results for all segments to the extent that they apply. A segment represents multiple products grouped together for the purpose of performing the Field Testing. See Section 4, Segment-Level Results, for further details on all segments. Additional detail on the Field Testing approach is included within Appendix F.

Our analysis provides certain clarifications or explanations dependent on the type of long-duration contract. Per ASC 944-20, the types of long-duration contracts include:

- Traditional life insurance and fixed annuity contracts, including limited-payment insurance contracts (referred to as "traditional life insurance contracts")
- Participating life insurance contracts
- Universal life-type contracts
- Nontraditional fixed and variable annuity life insurance contracts (referred to as "nontraditional life insurance contracts")
- Investment contracts

Details about the characteristics of each of these types of contracts are further outlined in Appendix A, Types of Insurance Contracts, while a brief summary of the targeted improvements is outlined in Appendix B, Summary of the Targeted Improvements.

3.1 Traditional and Limited-Payment Long-Duration Contracts

The terms of the contracts within this category are fixed and guaranteed, and the insurance entity bears the investment risk associated with the investment assets. We continue to refer to the contracts in this category under the legacy terms as FAS 60\(^9\) long-duration contracts for the traditional life insurance contracts, and FAS 97\(^10\) Limited-Payment (LP) products for the annuity contracts such as single premium immediate annuities. The products included in the Field Testing from this category are:

<table>
<thead>
<tr>
<th>Product</th>
<th>Model</th>
<th>Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term</td>
<td>FAS 60</td>
<td>Traditional Life</td>
</tr>
<tr>
<td>Whole Life (WL)</td>
<td>FAS 60/FAS 97 LP</td>
<td>Traditional Life</td>
</tr>
<tr>
<td>Single Premium Immediate Annuity (SPIA)</td>
<td>FAS 97 LP</td>
<td>Retirement</td>
</tr>
<tr>
<td>Retirement Income</td>
<td>FAS 60</td>
<td>Retirement</td>
</tr>
<tr>
<td>Long-Term Care (LTC)</td>
<td>FAS 60</td>
<td>Retirement</td>
</tr>
</tbody>
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3.1.1 Liability for Future Policy Benefits

Liabilities for future policy benefits are recorded for traditional life insurance contracts and reflect future obligations to policyholders. For LP insurance contracts, this liability also often includes a DPL. This section focuses on the assumptions and methodologies used in measuring these balances, excluding discounting and discount rates, which are discussed separately in Section 3.1.2 below.

3.1.1.a. Existing Guidance

Traditional Life Insurance

The liability for future policy benefits is the present value of future benefits to be paid to or on behalf of policyholders and related expenses less the present value of future net premiums (portion of gross premium required to provide for all benefits and expenses). The liability is estimated using methods that include assumptions, such as estimated expected investment yields, mortality, morbidity, terminations, and expenses, applicable at the time the insurance contracts are made. The assumptions also include provision for the risk of adverse deviation (PAD).

These original (locked-in) assumptions continue to be used in subsequent accounting periods to determine changes in the liability for future policy benefits unless a premium deficiency exists. Testing for shadow premium deficiency is also a requirement.

Limited-Payment Contracts

The liability valuation is based on the traditional life insurance model described above. However, because the collection of premium under a limited-payment contract does not represent the completion of an earnings process, any gross premium received in excess of the net premium is deferred and recognized in income in a constant relationship with insurance in force (if accounting for life insurance contracts) or with the amount of expected future benefit payments (if accounting for annuity contracts).

3.1.1.b. Targeted Improvements

An insurance entity would be required to update (unlock) all cash flow assumptions used in calculating the liability for future policy benefits on an annual basis, at the same time every year, or more frequently if actual experience or other evidence indicates that earlier assumptions should be revised.

A PAD would not be included in the calculation of the liability. In addition, as a result of the requirement to annually update all assumptions used in the calculation of the liability for future policy benefits, a premium deficiency test would not be required.

Cash flow assumptions used to calculate net premiums would be updated as of the contract issue date using actual historical experience and updated future cash flow assumptions (that is, on a retrospective basis). The revised ratio of net premiums to gross premiums should be applied retrospectively as of the contract issue date to derive an updated liability for future policy benefits, discounted at the original (that is, contract issuance) discount rate. The updated liability for future policy benefits should then be compared with the carrying amount of the liability for future policy benefits to determine the cumulative catch-up
adjustment to be recognized in current-period benefit expense. In subsequent periods, the revised ratio of net premiums to gross premiums, which should not exceed 100%, should be used to value the liability for future policy benefits, subject to future revisions.\textsuperscript{11}

The net premium ratio would be capped at 100% so that losses are not deferred into future periods. To the extent that the present value of future benefits and expenses exceeds the present value of future gross premiums, an immediate charge should be recognized to current-period benefit expense such that net premiums are set equal to gross premiums. In subsequent periods (that is, until assumptions are subsequently updated), the liability for future policy benefits should be accrued with net premiums set equal to gross premiums. In no event should the liability for future policy benefits balance be less than zero.\textsuperscript{12} For contracts following the FAS 97 LP model, changes in the net premium ratio would be applied to derive a cumulative catch-up adjustment to amortization of the DPL to be recorded in current-period earnings. The DPL cannot be less than zero so that losses are not deferred into future periods.

Transition

At the transition date, an insurance entity would apply the following transition methods for the liability for future policy benefits:

1. Retrospective application to all prior periods using actual historical information at the level of aggregation at which reserves are calculated;

2. If actual historical information covering the entire contract period is not available at the level of aggregation at which reserves are calculated, the use of estimates of historical information would be allowed for those periods in which actual historical information is not available. In those cases, an entity need not undertake exhaustive efforts to obtain objective information that is not reasonably available; or

3. If it is impracticable to apply either 1 or 2, the entities would apply the guidance to in-force contracts on the basis of their existing carrying amounts at the transition date and by using updated assumptions, adjusted for the removal of any amounts in Accumulated Other Comprehensive Income (AOCI).

3.1.1.c. Approach and Simplifications

For traditional contracts, when cash flow assumptions were updated, a revised net premium ratio was calculated, and a cumulative catch-up adjustment was recorded in current-period earnings. Because actual results were not available in sufficient detail, actual experience was not reflected when updating the net premium. The net premiums were adjusted only for changes in future cash flow assumptions.

Any PAD was removed from the projected cash flows.

The net premium ratio used for transition was based on average of cohorts issued during the field test period.

\textsuperscript{11} Based on proposed paragraph 944-40-35-6A.
\textsuperscript{12} Proposed paragraph 944-40-35-7A.
3.1.1.d. Key Observations

Full-retrospective adjustment of the net premium ratio, reflecting actual historical experience, is operationally complex and would produce adjustments that would be difficult to explain to users. This has been an issue under the existing guidance for DAC on nontraditional and participating long-duration contracts, leading to non-GAAP measures. FASB eliminated this adjustment as part of the DAC simplification efforts. Introducing retrospective measurement for reserves adds undue complexity for minimal practical benefit. The Board should consider changing the requirement to a prospective unlocking instead. We did not observe a significant difference between prospective and retrospective unlocking in the Field Testing for these products. The prospective transition method minimized the difference between the two unlocking approaches over the short Study Period. We would expect that over a longer period, greater differences would emerge. Section 7 provides an example that clearly illustrates the differences between the methods.

3.1.2 Discount Rate/Other Comprehensive Income

3.1.2.a. Existing Guidance

The interest rate assumption used in estimating the liability for future policy benefits is based on estimates of investment yields (net of related investment expenses) expected at the time insurance contracts are issued. The interest rate assumption for each block of new insurance contracts should be consistent with circumstances, such as actual yields, trends in yields, and the entity’s general investment experience.

3.1.2.b. Targeted Improvements

All long-duration contracts that are discounted using an investment yield under current accounting would be discounted using a yield based on a portfolio of high-quality fixed-income instrument yield. For tenors beyond which observable information is available, the discount rate would be estimated consistent with a level 3 fair value estimate.

Discount rate assumptions would be updated using an immediate approach with the effect of discount rate changes recorded immediately in OCI. The amount included in accumulated OCI (AOCI) would represent the difference between the carrying amount of the liability for future policy benefits using updated discount rates and locked-in rates at contract inception. Net premiums are not updated for discount rate assumption changes. The interest accretion rate would remain the original discount rate used at contract issue date.

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13 ASC 944-40-30-8.

14 Proposed paragraph 944-40-35-6A should be edited to clarify that the carrying amount for that paragraph differs from the carrying amount in the next paragraph. In particular, Item (a) of 6A could refer to “the carrying amount of the liability for future policy benefits (calculated using the original discount rates)”... Without this edit, the “carrying amount” referred to in Item (a) could be interpreted as the amount on the balance sheet, which is calculated using current discount rates. That would cause the reported impact of a cash flow assumption change to be confounded with the impact of previous discount rate changes. That would be inconsistent with the guidance in Item (b) of 6A.
Transition
At the transition date, an insurance entity should compare the liability for future policy benefits balance using the revised issue date discount rate (that is, the interest accretion rate) and the current discount rate (that is, the updated high-quality fixed-income instrument yield applied to the measurement of the liability for future policy benefits as of the transition date) in which the difference in the liability for future policy benefits balance is recorded to AOCI. 15

3.1.2.c. Approach and Simplifications
As there are not sufficient observable rates at all tenors, the high-quality fixed-income rate (AA Corporate bond rate) was graded to 5.75% in years 30 to 40 and kept constant thereafter. The Field Testing was performed by interpreting proposed paragraph 944-40-35-6A (a) as comparing to the value calculating using the original discount rates.

3.1.2.d. Key Observations
Reflecting the change in the liability for future policy benefits attributable to interest rate changes in OCI for FAS 60 liabilities created a better match with the assets measured as fair value through OCI.

There could be a loss at inception if a company does not price with AA rates, although we did not observe this in the Field Testing.

Grading the existing bond rates to an ultimate long-term assumption rather than, for example, assuming the last observable point applies to all longer tenors avoided non-economic volatility in pretax comprehensive income. The Board’s clarification that an estimate can be made for these tenors was thus an important improvement from the 2013 exposure draft.

3.1.3 Deferred Acquisition Costs
3.1.3.a. Existing Guidance
DAC is amortized to expense (a) in proportion to premium revenue recognized and (b) using methods that include the same assumptions used in estimating the liability for future policy benefits. 16 17

Because all assumptions are locked in at inception, amortization of DAC from inception incorporates future expected acquisition costs associated with renewals. For limited-payment contracts, the DPL is reduced by the deferrable acquisition costs that are required to be expensed upon the receipt of premium to avoid a gain or loss at issue.

3.1.3.b. Targeted Improvements
DAC for all long-duration contracts (other than certain investment contracts) would be amortized over the expected life of a book of contracts in proportion to the undiscounted amount of insurance in force with no interest accretion. Amortization should be calculated on

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15 Proposed paragraph 944-40-55-13L.
16 ASC 944-30-35-3.
17 ASC 944-30-35-17.
the basis of costs that have been capitalized – that is, future expected costs should not be contemplated. If the amount of insurance in force over the expected term of the related contract cannot be reasonably estimated, DAC should be amortized on a straight-line basis.

Capitalized acquisition costs should be reduced for actual experience in excess of expected experience, and the effect of future estimates should be recognized on a prospective basis. Interest would not be accreted on DAC, and the DAC asset would not be subject to an impairment test.

Transition

The guidance on DAC would be applied as of the transition date on the basis of the existing carrying amounts at that date, adjusted for the removal of any related amounts in AOCI (shadow DAC adjustments).

3.1.3.c. Approach and Simplifications

We used the existing carrying amount of DAC as of the transition date with the removal of shadow DAC adjustments. In accordance with the targeted improvements, the “DAC balance by issue year” cohort was amortized in proportion to expected face amount. We used policy count if face amount was not readily available.

3.1.3.d. Key Observations

After transition, amortization of DAC for newly issued contracts would include only amortization of historic deferrable commissions incurred plus other deferrable acquisition costs.

The DAC balance at transition would have already reflected the partial amortization of expected future deferrable renewal commissions, partially offsetting the accrual of interest that would also be included in the DAC balance at transition.

There were no material changes to DAC amortization for the products tested over the Study Period.

3.2 Nontraditional Long-Duration Contracts

This category includes insurance contracts with terms that are not fixed or guaranteed as well as the contracts that do not contain significant insurance risk but which include surrender charges or significant revenue from sources other than the investment of policyholder funds (i.e., investment contracts). We continue to refer to the contracts in this category under the legacy terms such as FAS 97 Universal life (UL) contracts and FAS 97 Investment Contracts (IC). Products included in the Field Testing from this category are:

<table>
<thead>
<tr>
<th>Product</th>
<th>Model</th>
<th>Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable Annuity (VA)</td>
<td>FAS 97 UL</td>
<td>Variable Annuity</td>
</tr>
<tr>
<td>Universal life with Secondary Guarantee (ULSG)</td>
<td>FAS 97 UL</td>
<td>Participating</td>
</tr>
</tbody>
</table>
3.2.1 Liability for Policyholder Benefits

3.2.1.a. Existing Guidance

Base Liability

The liability for policy benefits for FAS 97 UL is equal to the sum of:

a. The balance that accrues to the benefit of policyholders at the balance sheet date (policyholder account balance)

b. Any amounts that have been assessed to compensate the insurer for services to be performed over future periods (unearned revenue liability)

c. Any amounts previously assessed against policyholders that are refundable on termination of the contract

The liability for FAS 97 IC is equal to the balance that accrues to the benefit of the policyholder at the balance sheet date (policyholder account balance).

For FAS 97 UL and FAS 97 IC with additional benefits (other insurance benefit or annuitization features), an additional liability may be required, reflecting the excess future benefits expected to be paid.

Additional liability for other insurance benefit features – FAS 97 UL only

If amounts are assessed against policyholders each period for the insurance benefit feature in a manner that is expected to result in profits in earlier years and subsequent losses from that insurance benefit function, then a liability is established in addition to the account balance to recognize the portion of such assessments that compensates the insurance enterprise for benefits to be provided in future periods.

The additional liability at the balance sheet date should be equal to:

a. The current benefit ratio\(^{18}\) multiplied by the cumulative assessments\(^{19}\)

b. Less the cumulative excess payments

c. Plus accrued interest

Changes in the additional liability each period are reported in earnings as a component of benefits expense. Assumptions used in calculating the additional liability should be revised when calculating the additional liability balance in subsequent periods, if actual experience or other evidence suggests that earlier assumptions should be revised. However, the assessment as to whether an additional liability is required is made only at contract inception and not revisited in subsequent periods.

\(^{18}\) This “benefit ratio” is defined as (a) the present value of total expected excess payments over the life of the contract, divided by (b) the present value of total expected assessments over the life of the contract. The benefit ratio may exceed 100%, resulting in a liability that exceeds cumulative assessments. Total expected assessments are the aggregate of all charges, including those for administration, mortality, expense, and surrender, regardless of how characterized.

\(^{19}\) The term “cumulative assessments” refers to actual cumulative assessments, including investment margins, if applicable, recorded from contract inception through the balance sheet date.
Additional liability for annuitization benefit features – FAS 97 UL and FAS 97 IC

Certain contracts provide for potential benefits in addition to the account balance that are payable only upon annuitization, such as annuity purchase guarantees, guaranteed minimum income benefit (GMI), and two-tier annuities. Insurance enterprises first determine whether such contract features should be accounted for as embedded derivatives at fair value. If the contract feature is not accounted for as an embedded derivative at fair value, an additional liability for the contract feature is established if the present value of expected annuitization payments at the expected annuitization date exceeds the expected account balance at the expected annuitization date.

The additional liability at the balance sheet date should be equal to:

a. The current benefit ratio\(^{20}\) multiplied by the cumulative assessments
b. Plus accreted interest
c. Less, at time of annuitization, the cumulative excess payments determined at annuitization

Changes in the additional liability each period are reporting in earnings as a component of benefits expense. Assumptions used in calculating the additional liability should be revised when calculating the additional liability balance in subsequent periods if actual experience or other evidence suggests that earlier assumptions should be revised. However, the assessment as to whether an additional liability is required is made only at contract inception and not revisited in subsequent periods.

3.2.1.b. Targeted Improvements

All additional benefits associated with variable FAS 97 UL and FAS 97 IC would first be assessed to see if they qualify as "market risk benefits" and, if so, would be accounted for as follows:

- Measured at fair value:
  - The portion of the fair value change attributable to a change in instrument-specific credit risk would be recognized in OCI.
  - The carrying amount would be presented as a separate line item in the statement of financial position, and the change in fair value (excluding the portion relating to changes in instrument-specific credit risk) would be reported as a separate line item in the statement of operations.

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\(^{20}\) This "benefit ratio" is defined as (a) the present value of expected annuitization payments to be made and related incremental claim adjustment expenses, discounted at estimated investment yields expected to be earned during the payout phase of the contract, minus the expected accrued account balance at the expected annuitization date, divided by (b) the present value of total expected assessments over the life of the contract. Total expected assessments are the aggregate of charges, including those for administration, mortality, expense, and surrender, regardless of how characterized.
The "market risk benefits" accounting model above applies to contracts and benefits that meet both of the following criteria:

- **Contract**: The contract holder has the ability to direct funds to one or more separate account investment alternatives, and investment performance, net of contract fees and assessments, is passed through to the contract holder. The separate account need not be legally recognized or legally insulated from the general account liabilities.

- **Benefit**: The insurance entity provides a benefit protecting the contract holder from adverse capital market performance, exposing the insurance entity to other-than-nominal capital market risk. A nominal risk is a risk of insignificant amount or with a remote probability of occurring.
  a. A benefit is presumed to have other-than-nominal capital market risk if the net amount at risk (that is, the guaranteed benefit in excess of the account balance, cash value, or similar amount) varies more than an insignificant amount in response to capital market volatility.
  b. Capital market risk includes equity, interest rate, and foreign exchange risk.

Contracts and benefit features that do not meet these criteria would follow the existing guidance, as described above, with the added condition that the benefit ratio may not exceed 100%. The assessment as to whether an additional liability should be recorded for FAS 97 UL or FAS 97 IC would be made in conjunction with other assumption updates (i.e., at least annually), versus only at inception under the existing guidance.

**Transition**

At the transition date, an insurance entity would measure market risk benefits at fair value by means of retrospective application in accordance with the existing fair value guidance. The transition adjustment would be recorded as follows:

1. The cumulative effect of changes in instrument-specific credit risk between contract issue date and transition date would be recognized in AOCI.

2. The difference between the fair value and carrying value at the transition date, excluding the amount in item 1 above, would be adjusted to opening retained earnings.

An insurance entity is required to record and disclose the additional liability at transition for a guarantee associated with FAS 97 UL or FAS 97 IC.

**3.2.1.c. Approach and Simplifications**

Certain guarantees, including GMIBs and guaranteed minimum accumulation benefits, are already characterized under existing guidance as embedded derivatives and measured at fair value with movements recognized in the income statement. For these benefits, only the impact of the instrument-specific credit risk was moved from net income to OCI. For guarantees not previously measured at fair value, we measured the guarantee at fair value, with the change in fair value reported in net income, except for the portion of the change that was related to instrument-specific credit risk, which was reported in OCI. As the transition rules were unclear
at the time of field testing, multiple techniques were used to estimate the attributed fee, including setting it so that the new reserve is equal to the old SOP 03-1 reserve, and estimating what the attributed fee would have been based on the company's profitability targets at the time.

3.2.1.d. Key Observations

For market risk benefits that are currently measured under SOP 03-1, the volatility of the reserves increased under the targeted improvements when interest rates and other market inputs changed.

For market risk benefits, we agree with the tentative decision to report the impact of changes in instrument-specific credit risk in OCI rather than in net income. This keeps volatility from changes in instrument-specific credit risk from distorting net income.

Although the remaining additional volatility from reporting all market risk benefits at fair value can arguably be considered economic volatility, FASB should consider excluding death benefits from the tentative decision on market risk benefits. This would retain SOP 03-1 accounting for death benefits. Market value is less relevant for these benefits since death benefits are not payable unless the insured dies. Therefore, the risk of having to pay out in adverse market conditions is mitigated as there would generally be time for the market to recover before any death benefit is paid. This is consistent with the results of our Field Testing, where most of the change in volatility in the measured liability as a result of the targeted improvements came from the living benefits, not the death benefits, despite more of the contracts containing guaranteed death benefits than living benefits under SOP 03-1.

While we did not explicitly include reinsurance in the Field Testing, the results demonstrate that there is a significant difference in the financial statements between reporting market risk benefits at fair value versus reporting under SOP 03-1. (See Exhibit 4.4.1B.) This means that substantial accounting mismatches would result if the direct benefits are reported at fair value but reinsurance of the benefits is reported under SOP 03-1. Therefore, we agree with the targeted improvements that reinsurance of market risk benefits should be accounted for consistently with the direct market risk benefits.

Observations related to transition

The volatility shown in the Field Testing for market risk benefits at fair value versus SOP 03-1 indicates that a retrospective transition of these market risk benefits could be very disruptive to insurance company balance sheets. We interpret the guidance in the targeted improvements requiring retrospective transition as requiring the attributed fee be estimated as what it would have been had it been set when the contract was issued. We are concerned that the cumulative effect of changes to market risk benefit values, many of which were issued prior to the financial crisis, may be to increase the values to an extent that would dramatically impact some insurers' GAAP equity. We are concerned that users, including some regulators, may not understand this change or the resulting increase in future net income.

We also have practical concerns with retrospective transition. We used a prospective approach for Field Testing because it would be difficult to go back in history to recalculate attributed fees for contracts sold 5, 10, or more years ago. Retrospective transition for market risk benefits would often be more complex than for traditional contracts issued at the same time because of
the need to calibrate and generate stochastic economic scenarios to determine the attributed fee on a market risk benefit. Given the dramatic economic events of the past decade, it would be particularly difficult to calibrate economic scenarios objectively without the use of hindsight. For example, it would likely be impossible for an actuary calibrating economic scenarios to retrospectively determine an attributed fee for a market risk benefit issued in 2005 to avoid being influenced, at least subconsciously, by the foreknowledge that low-probability events such as the financial crisis and negative interest rates in several currencies have actually occurred. So measuring the attributed fee for in-force contracts at transition will generally not be possible without the use of hindsight.

These problems can be avoided. The attributed fee is an element of a market risk benefit that is not defined for SOP 03-1 reserves. And the attributed fee represents an allocation between fees associated with the host insurance contract and the fees associated with the market risk benefit. Any fee allocated to the market risk benefit would then be unavailable to be shown as profit within the host contract. The attributed fee allocated to the market risk benefit can be calibrated at transition using an approach consistent with the approach used for DAC and the simplified approach used for FAS 60 future policy benefit reserves. Thus, the attributed fee should be set at transition such that there is no change to the liability, provided the attributed fee is between 0 and 100% of the policy charges. In other words, as long as the attributed fee falls within reasonable parameters, the market risk benefit at transition can be defined in a way that causes the fair value of the market risk benefit upon transition to equal the SOP 03-1 reserve on the transition date. That would avoid the problems of practicability, hindsight and confusing impacts to financial statements.

Observations related to the additional liability for SOP 03-1 benefits

The guidance in ASC 944-40-35-10 accumulates an additional liability for SOP 03-1 benefits. The targeted improvements propose that the benefit ratio may not exceed 100%. This does not, in and of itself, result in immediate loss recognition when the reserve is calculated as an accumulation rather than as a present value. For example, if a contract is onerous at issue, there has been no time to accumulate any additional reserve, but it could be appropriate to establish an additional reserve equal to the excess of the present value of expected excess payments over the present value of expected assessments. To work properly after issue, an equivalent formula is recommended. To accomplish the desired effect, a subparagraph (d) should be added, as follows, and the text that was added in the targeted improvements (capping the benefit ratio at 100%) should be deleted:

"d. Plus, if the current benefit ratio exceeds 100 percent, the excess of the benefit ratio over 100 percent multiplied by the present value of future assessments, including investment margins, if applicable."

Similar changes should be made to 944-40-35-14 for annuitization benefits. We also note one technical item related to SOP 03-1 reserves. The targeted improvements notes that fees included within market risk benefits cannot also be used as assessments for calculating SOP 03-1 reserves. This should be expanded to also include fees included within any embedded derivatives within the contract so that neither market risk benefit fees nor embedded derivatives are double-counted within the SOP 03-1 reserves.
3.2.2 Discount Rate for Guarantees Associated with FAS 97 UL and FAS 97 IC

3.2.2.a. Existing Guidance

For additional liabilities for FAS 97 UL and FAS 97 IC, the present value of excess benefits and future assessments is computed using the rate of interest that accrues to policyholder balances (sometimes referred to as the contract rate). This rate is either the rate in effect at the inception of the book of contracts or the latest revised rate applied to the remaining benefit period (i.e., an accounting policy election).

The present value of expected annuity payments and related claim adjustment expenses are discounted at expected investment yields.

3.2.2.b. Targeted Improvements

The expected investment yield used in the present value for purposes of measuring the additional liability for annuitization benefits is replaced with the high-quality fixed-income instrument yield and updated at each balance sheet (i.e., measurement) date. See Section 3.1.2b for additional information with respect to the high-quality fixed-income instrument yield.

3.2.2.c. Approach and Simplifications

See Appendix F.

3.2.2.d. Key Observations

None.

3.2.3 Deferred Acquisition Costs

3.2.3.a. Existing Guidance

DAC\(^{21}\) is amortized at a constant rate based on the present value of the estimated gross profit amounts expected to be realized over the life of the book of contracts.\(^{22}\)

3.2.3.b. Targeted Improvements

DAC for all long-duration contracts (other than certain investment contracts) would be amortized over the expected life of a book of contracts in proportion to the undiscounted amount of insurance in force with no interest accretion. Amortization should be calculated on the basis of costs that have been capitalized — that is, future expected costs should not be contemplated.

If the amount of insurance in force over the expected term of the related contract cannot be reasonably estimated, DAC should be amortized on a straight-line basis.

\(^{21}\) Including other balances such as value of business acquired, deferred sales inducement, and unearned revenue liability.

\(^{22}\) ASC 944-30-35-4.
Capitalized acquisition costs should be reduced for actual experience in excess of expected experience, and the effect of future estimates should be recognized on a prospective basis. Interest would not be accreted on DAC, and the DAC asset would not be subject to an impairment test.

Transition

The guidance would be applied as of the transition date on the basis of the existing carrying amounts at that date, adjusted for the removal of any related amounts in AOCI (shadow DAC adjustments).

3.2.3.c. Approach and Simplifications

We used the existing carrying amount of DAC as of the transition date with the removal of shadow DAC adjustments. In accordance with the targeted improvements, the "DAC balance by issue year" cohort was amortized in proportion to the expected face amount. We used policy count if face amount was not readily available.

3.2.3.d. Key Observations

After transition, amortization of DAC for newly issued contracts would include only amortization of actual deferrable commissions incurred plus other deferrable acquisition costs. The DAC balance at transition would have already reflected the partial amortization of expected future deferrable renewal commissions, partially offsetting the accrual of interest that would also be included in the DAC balance at transition.

3.3 Participating Life Insurance Contracts (Primarily Mutual Insurers/Closed Block)

This category includes insurance contracts that are expected to pay dividends to policyholders from the divisible surplus of the company in approximately the same proportion as the contracts are considered to have contributed to divisible surplus (commonly referred to in actuarial literature as the contribution principle). Such contracts are typically issued by mutual insurance companies but may also be issued by stock companies and other entities, typically with restrictions on the amount that may be distributed to stockholders. This includes closed blocks of businesses created through demutualizations.

We continue to refer to the contracts in this category under the legacy terms as FAS 12023 and SOP 95-1. The product included in the Field Testing from this category is:

<table>
<thead>
<tr>
<th>Product</th>
<th>Model</th>
<th>Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participating Whole Life (Par WL)</td>
<td>FAS 120</td>
<td>Participating</td>
</tr>
</tbody>
</table>

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3.3.1 Future Policyholder Benefits

3.3.1.a. Existing Guidance

Participating Life Insurance

The liability for future policyholder benefits relating to certain participating life insurance contracts\textsuperscript{24} is equal to the sum of the net level premium reserve for death and endowment policy benefits, the liability for terminal dividends, and any probable loss (premium deficiency). Terminal dividends are accrued in the liability for future policy benefits if both the payment of the dividend is probable and the amount can be reasonably estimated.

Future policyholder dividends, other than the terminal dividends, are not included in the future policy benefits determination.

The net level premium reserve is calculated based on the dividend fund interest rate and mortality rates guaranteed in calculating the cash surrender value. See Section 3.3.2 below for further discussions.

Although current guidance does not specifically state that assumptions should be locked in, they are in practice because assumptions are based on contract guarantees. Similarly, although there is no explicit PAD, contractual guarantees include margins that are expected to provide contributions to surplus from which dividends will be paid.

Closed Block

The accounting principle used to determine the future policyholders' benefits for the policies associated with the closed block is the same as for similar policies that are not part of the closed block; however, an additional policyholder dividend obligation (PDO) liability is also established. The PDO represents any cumulative earnings from the closed block since it was established in excess of the cumulative earnings that had been expected to date. The PDO cannot be negative, so if cumulative closed block earnings have been less than expected, there is no "PDO asset," even if the insurer has the ability to make up the difference in the future.

3.3.1.b. Targeted Improvements

Participating contracts would be measured similarly to traditional and limited-payment contracts (see Section 3.1.1.b). The estimated future policyholder dividends would need to be included in the projected cash flows when determining the future policyholder benefits balance. Terminal dividends would also be included in the best-estimate projected cash flows.

\textsuperscript{24} This applies to participating life insurance contracts that meet the criteria in paragraph 944-20-15-3. That paragraph states that participating life insurance contracts denote those that have both of the following characteristics: (1) they are long-duration participating contracts that are expected to pay dividends to policyholders based on actual experience of the insurance entity, and (2) annual policyholders' dividends are paid in a manner that both identifies divisible surplus and distributes that surplus in approximately the same proportion as the contracts are considered to have contributed to divisible surplus (commonly referred to in actuarial literature as the contribution principle).
The provision for future policy benefits would be unlocked for cash flow assumptions each reporting period. Changes to the provision for future policy benefits due to the changes in insurance assumptions would be reflected through net income, while changes due to the changes in the discount rate would be recorded through OCI. Experience adjustments would be recognized in the period in which that experience arises.

Transition

The guidance for transition for participating contracts is the same as was discussed above in Section 3.1.1.b for traditional life insurance and annuity contracts – if complete data is available back to the policy issue date, or is reasonably available on an estimated basis, then that is used. Otherwise, the existing carrying amount (including terminal dividend liability) is reported on the transition date with updated future assumptions.

3.3.1.c. Approach and Simplifications

We calculated the liability for future policy benefits for participating life insurance contracts using expected future cash flows, including dividends and terminal dividends. The projected dividends reflected investment earnings of a portfolio where new investments and reinvestments were high-quality fixed-income instruments (the same as the discount rates). When insurance assumptions were updated, the net premium was recalculated from issue, and a cumulative catch-up adjustment was recorded in current-period earnings.

Because actual results were not available by cohort, these were not reflected in the unlocking of the net premium. Changes in dividends were all treated as a change in insurance assumptions, causing an unlocking of net premiums.

3.3.1.d. Key Observations

The Field Testing did not show a large difference between the existing FAS 120 accounting and the targeted improvements, even though there are significant conceptual issues with the targeted improvements for participating contracts. These issues relate to:

1. Using a discount rate that is inconsistent with the dividend credited rate of the contract;
2. Locking in the interest accretion rate used to determine net income, even though projected cash flows change with changes in dividend credited rates; and
3. Unlocking the net premium ratio for changes in cash flows related to dividend credited rates but not for changes in interest accretion rates.

Although it is not evident in the segment results, we encountered the first issue. For a couple of issue years, the discount rate (based on current yield curve for AA-rated securities) was sufficiently lower than the dividend credited rate (based primarily on portfolio book yields) such that contracts issued in those years appeared to be onerous.

The second and third issues were not prominent in the Field Testing results. This is because we determined the net premium ratio upon transition for in-force contracts as a single cohort. Since the Field Testing only extended for five years after the establishment of the initial net premium ratio, changes in projected cash flows resulting from dividend credited rate changes
were almost entirely offset by retrospective unlocking, reducing the magnitude of the mismatch with the locked-in interest accretion rate. However, this retrospective unlocking offset would decline over time.

Another issue we did not address in field testing is alignment of the timing of discount rate changes and dividend credited rate changes. Because both are related to changes in interest rates, it is important that both be updated at the same time, i.e., each reporting period. But since the field testing calculations were performed annually, both discount rates and dividend credited rates were updated annually.

Because the circumstances under which the Field Testing was performed masked the conceptual concerns with the targeted improvements, we performed a separate simplified example that demonstrates these issues. This example is discussed in Section 5.

To address these issues, we proposed suggested changes in Section 5. Given that the use of the contribution principle allows the contracts to adjust to experience as it develops, it is not clear that the benefit of the targeted improvements would be worth the cost.

For participating contracts within a closed block established on demutualization, we recommend that the liability be equal to the reported value of the assets in the closed block unless the assets are inadequate to defease the liabilities. This additional liability could be calculated consistent with the targeted improvements for FAS 97 UL contracts, monitoring for whether an SOP 03-1 reserve is needed to fund an expected deficiency, or by putting up a fair value reserve for any expected deficit if and when the assets become inadequate.

Results for the participating segment, to be discussed in Section 4 below, combine participating business with UL business. Hence, it is difficult to draw conclusions about the participating business on its own from the segment results.

3.3.2 Discount Rate/Other Comprehensive Income

3.3.2.a. Existing Guidance

When calculating the net level premium reserve, the dividend fund interest rate is used if determinable. If the dividend fund interest rate is not determinable, the guaranteed interest rate used in calculating cash surrender value described in the contract is used. If the dividend fund interest rate is not determinable and there is no guaranteed interest rate, the interest rate used in determining guaranteed non-forfeiture values is used. Finally, if none of the above rates exist, then the interest rate used to determine minimum cash surrender values – as set by the NAIC’s model standard non-forfeiture law – for the year of issue of the contract is used.

3.3.2.b. Targeted Improvements

All long-duration contracts (including participating contracts) that are discounted using an investment yield under the existing guidance would be discounted using a rate based on a high-quality fixed-income instrument yield.
3.3.2.c. Approach and Simplifications

As there are not sufficient observable rates at all tenors, the high-quality fixed-income instrument yield (AA Corporate bond rate) was graded to 5.75% in years 30 to 40 and kept constant thereafter.

Discount rate assumptions were updated using an immediate approach whereby the effect of discount rate changes was recorded immediately in OCI.

3.3.2.d. Key Observations

Grading the existing bond rates to an ultimate long-term assumption rather than, for example, assuming the last observable point applies to all longer tenors avoided non-economic volatility in pretax comprehensive income.

3.3.3 Deferred Acquisition Costs

3.3.3.a. Existing Guidance

The amortization method for participating life insurance contracts is consistent with UL contracts. For purposes of that calculation, the present value of estimated gross margins is computed using the expected investment yield.25

3.3.3.b. Targeted Improvements

DAC for all long-duration contracts (other than certain investment contracts) would be amortized over the expected life of a book of contracts in proportion to the undiscounted amount of insurance in force with no interest accretion. Amortization should be calculated on the basis of costs that have been capitalized — that is, future expected costs should not be contemplated.

If the amount of insurance in force over the expected term of the related contract cannot be reasonably estimated, DAC should be amortized on a straight-line basis.

Capitalized acquisition costs should be reduced for actual experience in excess of expected experience, and the effect of future estimates should be recognized on a prospective basis. Interest would not be accreted on DAC, and the DAC asset would not be subject to an impairment test.

Transition

The guidance would be applied as of the transition date on the basis of the existing carrying amounts at that date, adjusted for the removal of any related amounts in AOCI (shadow DAC adjustments).

25 ASC 944-30-35-11.
3.3.3.c. Approach and Simplifications

The “DAC balance by issue year” cohort was amortized in proportion to expected policy count since future face amounts were not readily determinable.

We used the existing carrying amount of DAC as of the transition date, with the removal of shadow DAC adjustments.

We acknowledge the wording in the targeted improvements that if amortization, based on the proportion to the amount of insurance in force, cannot be reasonably estimated, then straight-line amortization should be used. We understand that the underlying rationale for the use of the straight-line amortization method is to account for situations where the pattern of economic benefits consumed cannot be reliably determined. Amortization based on expected policy counts, when face amounts are not reasonably estimated, provided for a reliably determinable method of amortization, and is in the spirit of and preferable to simply requiring the straight-line method.

3.3.3.d. Key Observations

After transition, amortization of DAC for newly issued contracts would include only amortization of actual deferrable commissions incurred plus other deferrable acquisition costs. The DAC balance at transition would have already reflected the partial amortization of expected future deferrable renewal commissions, partially offsetting the accrual of interest that would also be included in the DAC balance at transition.

3.4 Premium Deficiency and Loss Recognition

3.4.1 Existing Guidance

A premium deficiency exists when existing contract liabilities, together with the present value of future gross premiums, would not be sufficient to cover the present value of future benefits to be paid to or on behalf of policyholders, maintenance costs relating to a block of long-duration contracts, and would not be sufficient to recover unamortized acquisition costs.

In the case where a particular line of business is sufficient in the aggregate, but circumstances exist such that profits in earlier years are followed by losses in later years, a liability is recognized in order to offset the losses that would be recognized in those later years.

3.4.2 Targeted Improvements

The premium deficiency testing in existing guidance would be eliminated as entities are now required to annually update all cash flow assumptions used in the calculation of the liability (or additional liability for UL contracts) for future policy benefits.
As a result, the net premium ratio would be capped at 100% so that losses are not deferred into future periods. To the extent the present value of future benefits and expenses exceeds the present value of future gross premiums, an immediate charge should be recognized to current-period benefit expense such that net premiums are set equal to gross premiums. In no event should the liability for future policy benefits balance be less than zero.  

3.4.3 Approach and Simplifications

We capped net premiums at 100%.

3.4.4 Key Observations

We acknowledge that the targeted improvements that establish one consistent DAC amortization model for all long-duration contracts (except certain investment contracts) go a long way toward reducing complexity and enhancing user understandability. However, we are somewhat concerned about the decision to eliminate the premium deficiency/loss recognition requirements by simply changing the fundamental rationale behind what the DAC asset is deemed to represent and how it should be viewed, or not viewed, from an impairment perspective.

The long-duration contracts accounting model under the existing guidance for traditional insurance contracts includes a DAC premium deficiency test, which serves the purpose of ensuring that there is enough margin (profit) in the remaining renewals associated with the acquired insurance contracts to recover the remaining DAC balance at inception and at each balance sheet date. The short-duration contracts accounting model under the existing guidance likewise includes a DAC premium deficiency test, which serves the purpose of ensuring that there is enough margin (profit) in the remaining unearned premium reserve associated with the acquired insurance contracts to recover the remaining DAC balance at inception and at each balance sheet date. In both cases, if there is a deficiency, DAC is first reduced to zero, and then an additional liability is established. Targeted improvements would eliminate the requirement to perform this test after inception for long-duration contracts under the assumption that reserves would appropriately reflect updated assumptions at the balance sheet date.

It is important to note that the DAC premium deficiency test under the existing guidance is two-pronged. It is first an asset recoverability test and then, after the asset is fully charged off, becomes a liability adequacy test (given there are no more assets associated with these contracts). This is an integrated test, given the fact that on Day 1, the asset is deemed deferrable only because it is recoverable from profits inherent in the contracts acquired. The updating of reserve assumptions in targeted improvements appears to have eliminated the need for the liability adequacy test portion of the current test. However, it does not seem to acknowledge the fact that although a liability may have been reported using more current assumptions, there could be an asset that is no longer recoverable, as it was required to be at inception to be deferrable in the first place. For example, as the net premium ratio for a given portfolio of long-duration traditional insurance contracts increases to the point of 100%, there are no profits left to recover any associated DAC, and yet, the DAC remains an asset to be amortized to expense over years and potentially decades. In contrast, if a portfolio of short-

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28 Proposed paragraph 944-40-30-7A.
duration contracts turned out to be poorly priced such that the loss ratio was expected to be greater than 100% for the remainder of the contract period, the associated DAC would be immediately written off and then an additional reserve established.

Under the targeted improvements, a similar issue could arise for nontraditional long-duration contracts, in situations where DAC is amortized based on policy counts or on a straight-line basis and there are large unexpected partial surrenders (i.e., no decrease in policy counts), resulting in remaining accounting balances that do not generate enough profit to support the related DAC, unchanged as a result of the same policy count before and after the partial surrender.

To address these concerns, we recommend that the Board (1) acknowledge the inconsistency created between long- and short-duration contracts with respect to DAC recoverability and (2) strongly consider incorporating a mechanism in the model to avoid DAC balances that are not recoverable from the profits of the underlying issued contracts. Here is one recommendation to address this issue for traditional long-duration contracts without requiring an explicit impairment test:

When cash flow assumptions are updated (at least annually) and the net premium ratio is retrospectively adjusted, the DAC asset could be compared to the implicit margin (i.e., the current excess of the net premium valuation over the gross premium valuation). This test would be done at a level of aggregation consistent with current loss recognition testing. The ending DAC balance should not exceed this difference (i.e., implicit margin). If it does, additional amortization should be recorded in the period to cap the ending DAC at the implicit margin. This additional amortization should be separately disclosed in the DAC rollforward for transparency, or companies could be required to disclose the amount of DAC at each balance sheet date subject to this cap. The result of this method is that DAC would essentially be annually subject to the same recoverability test required on Day 1. At transition, DAC would be capped at the implicit margin for the associated cohort at the date of transition.

The application of this approach would result in:

- The DAC asset always being deemed recoverable at the level of aggregation required by current guidance from the implicit margin associated with the acquired contracts (i.e., always would meet the definition of an asset throughout its life);
- The DAC asset being effectively completely amortized by the time the aggregate implicit margin is gone, mitigating situations that could lead to profits followed by losses;
- No need for a new explicit impairment methodology; and
- Consistency between long- and short-duration accounting models with respect to DAC recoverability.
4. Segment-Level Results

For each segment, we present the financial information prepared using the targeted improvements, compared to the financial information prepared under the existing guidance, for the Study Period. Depending on the significance of the impact of the targeted improvement, we include all or some of the below analysis in our segment discussions for each of the four segments:

a. Pretax profit or loss;

b. Pretax OCI;

c. Pretax comprehensive income/(loss);

d. Change in insurance liability;

e. Components of insurance liability;\(^{27}\) and

f. DAC balance.

Segment results are driven by specific characteristics and features of the tested products as well as the impact of product aggregation into the segment results. Similar tests on different products could lead to different results. Key observations are discussed for each segment grouping. Many of these comments repeat comments in Section 3 above depending on the existing accounting for those products. The table below shows the segment for each product as previously shown in Section 3.

<table>
<thead>
<tr>
<th>Product</th>
<th>Model</th>
<th>Segment</th>
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</thead>
<tbody>
<tr>
<td>Term</td>
<td>FAS 60</td>
<td>Traditional Life</td>
</tr>
<tr>
<td>Whole Life (WL)</td>
<td>FAS 60/FAS 97 LP</td>
<td>Traditional Life</td>
</tr>
<tr>
<td>Single Premium Immediate Annuity (SPIA)</td>
<td>FAS 97 LP</td>
<td>Retirement</td>
</tr>
<tr>
<td>Retirement Income</td>
<td>FAS 60</td>
<td>Retirement</td>
</tr>
<tr>
<td>Long-Term Care (LTC)</td>
<td>FAS 60</td>
<td>Retirement</td>
</tr>
<tr>
<td>Variable Annuity (VA)</td>
<td>FAS 97 UL</td>
<td>Variable Annuity</td>
</tr>
<tr>
<td>Universal Life with Secondary Guarantee (ULSG)</td>
<td>FAS 97 UL</td>
<td>Participating</td>
</tr>
<tr>
<td>Participating Whole Life (Par WL)</td>
<td>FAS 120</td>
<td>Participating</td>
</tr>
</tbody>
</table>

4.1 Traditional Life Segment

4.1.1 Analysis of the Field Testing results

As expected, the new proposals with unlocked cash flow assumptions produce pretax income results that are more volatile and pretax OCI less volatile than the current standard (see Exhibits 4.1.1D and 4.1.1F, respectively). This volatility reflects assumption changes during the period.

\(^{27}\) All financial information is presented in currency units (CUs).
The targeted improvements result in higher reserves than the existing reserves for years 2010–2012 (see Exhibit 4.1.1A). This reflects the drop in current interest rates during these periods. This is confirmed since the reserves using locked-in rates are similar to the existing reserves, thereby showing the change between current and proposed levels of reserve is due to the use of the current interest rates.

We also did a sensitivity test under the prospective unlocking approach. The traditional segment reserves were lower under the prospective unlocking of the net premium ratio than under retrospective unlocking in all years except 2009. However, generalized conclusions about behavior of reserves under prospective versus retrospective unlocking methodology cannot be drawn from the Field Testing results for the reasons described below. A main concern with the targeted improvements is the requirement to unlock the net premium ratio retrospectively. As noted earlier in this Comment Letter, the difference between the prospective and retrospective unlocking does not appear to be large in the Field Testing (see Exhibit 4.1.1E) because of the method adopted for transition and the short observation period measured. Over a longer period of observation, we expect the prospective method to produce more useful information (see Section 7 for more on this subject).

Both prospective and retrospective unlocking provide some offset to fluctuations in net income resulting from experience deviations and from assumption changes. Prospective unlocking provides a full offset to changes in future assumptions, as long as the net premium ratio remains less than 100%, and provides no offset to experience deviations. Retrospective unlocking provides a partial offset to both assumption changes and experience deviations, again subject to the net premium ratio remaining less than 100%.

It is more appropriate to fully reflect experience deviations that have actually occurred in net income without smoothing the impact into other periods. And since assumption changes have not yet actually occurred and could actually be different, it seems most appropriate to use a methodology that offsets their impact to current income, so long as the contract is not onerous. Assumptions may change many times over the life of a contract, and in offsetting directions, so the most appropriate time to reflect the impact of a deviation in net income is when the deviation actually occurs.

Retrospective unlocking provides a partial offset to financial statements for actual deviations, while prospective unlocking provides an offset only to projected deviations that are assumed but have not actually occurred, and allows the full impact of actual cash flow deviations to be reported in the financial statements. As can be seen in Exhibit 4.1.1E, this can result in the prospective unlocking showing more volatility in net income than retrospective unlocking. But this is economic volatility, since it results from actual experience flowing through net income without offset under prospective unlocking, while those experience deviations get smoothed under retrospective unlocking. As a result, prospective unlocking produces a more representationally faithful view of the economics of the insurance contract’s performance. We also note that retrospective unlocking is much more costly to apply due to the need to maintain and update historical experience.

Reflecting the difference between the reserves at locked-in and current rates in OCI, rather than net income, for years 2008–2011 causes the results to appear similar to the existing guidance. Reflecting the difference between the reserves at locked-in and current rates in OCI resulted in significant unrealized asset gains being offset in OCI, particularly in 2012.
Exhibit 4.1.1A

Net Liability

- Current US GAAP
- FASB 2016 Proposed (current rates retrospective)
- FASB 2016 Proposed (locked in rates retrospective)

Exhibit 4.1.1B

Reserves (Prospective Sensitivity)

- FASB 2016 Proposed (current rates retrospective)
- FASB 2016 Proposed (locked in rates retrospective)
- FASB 2016 Proposed (current rates prospective)
- FASB 2016 Proposed (locked in rates prospective)
Exhibit 4.1.1E

Pretax Income/(Loss) – Prospective Method

Exhibit 4.1.1F

OCI (Pre-tax)
Exhibit 4.1.1G

Pretax Comprehensive Income/(Loss)

- Current US GAAP
- FASB 2016 Proposed
4.2 Retirement Segment

4.2.1 Analysis of Field Testing Results

Applying the targeted improvements and their interpretations to valuation of the retirement segment reserves results in the proposed reserves at current rates being lower than the reserves under the existing guidance at transition (see Exhibit 4.2.1A). This is attributable to retrospective recalculation of the net premium ratio at transition.

While the reserves at locked-in rates remained lower than the existing reserves for the entire Study Period, the reserves at current rates were higher than the existing reserves for years 2010 through 2012 due to the decrease in the current interest rates. Additionally, the rate of change year over year in proposed reserves at locked-in rates was similar to the existing reserves throughout the Study Period, causing little variation in pretax income for years 2008–2012 (see Exhibit 4.2.1E).

The Field Testing results did not produce any notable differences in the DAC balance and amortization between the existing guidance and the targeted improvements (see Exhibit 4.2.1D).

Proposed comprehensive income was lower but less volatile as changes in the discount rates were partially offset by the unrealized gains from the asset portfolio. Comprehensive income decreased in 2011, reflecting the drop in interest rates (see Exhibit 4.2.1H).

The Field Testing results showed a negligible difference in both reserves and pretax income between the retrospective and the prospective methods of unlocking the net premium ratio (see Exhibits 4.2.1B, 4.2.E, and 4.2.1F) due to retrospective unlocking only going back to transition at the beginning of the five-year Study Period. See Section 7 for more on this topic.

Exhibit 4.2.1A

![Net Liability Graph](image-url)
Exhibit 4.2.1B

Reserves (Prospective Sensitivity)

Exhibit 4.2.1C

Reserves (Discount Rate Sensitivity)
Exhibit 4.2.1H

Pretax Comprehensive Income/(Loss)

2008 2009 2010 2011 2012

CU

(2,000) (4,000) (6,000) (8,000) (10,000) (12,000)

Current US GAAP  FASB 2016 Proposed
4.3 Participating Segment

4.3.1 Analysis of Field Testing Results

Applying the targeted improvements and their interpretations to valuation of the Participating Segment reserves resulted in lower segment reserves at current rates as of the transition date than the existing reserves. The proposed reserves were higher than the existing reserves for years 2010–2012 since current interest rates decreased, causing reserves to increase (see Exhibit 4.3.1A). Additionally, the reserves at locked-in rates were lower than the existing reserves (reflecting the lower liability at transition) but followed a similar pattern of change, therefore showing little fluctuation in pretax income (see Exhibit 4.3.1D). The difference between the proposed reserves at current and at locked-in rates and the existing reserves at transition was due primarily to the update of the net premium ratio at transition.

The results for DAC under the targeted improvements showed a higher balance after year 2009 when compared to the existing DAC mainly due to the targeted improvements guidance changing the amortization basis (see Exhibit 4.3.1C).

The pretax income for the participating segment did not change significantly from the existing accounting (see Exhibit 4.3.1D). This was to be expected since the participating nature of the contracts tends to absorb the volatility of any assumption unlocking and changes in interest rates. It is important, however, that the assumptions used be consistent with how the dividends are calculated. Otherwise, there would be volatility caused by the lack of consistency rather than the actual economic volatility.

The results also do not vary much between prospective and retrospective unlocking of the net premium for the reasons cited in Section 4.1.1 (see Exhibit 4.3.1E). See Section 7 for more on this topic. For similar reasons, the results do not reveal some of the distortions to financials that could occur from certain targeted improvements. These are demonstrated in Section 5.

Reflecting the change in the liability for future policy benefits attributable to interest rate changes in OCI resulted in less volatile comprehensive income as the changes in the liabilities due to interest rate changes offset the changes in asset values (see Exhibit 4.3.1G). This is an improvement over the existing guidance.
Exhibit 4.3.1G

Pretax Comprehensive Income/(Loss)

- \( \text{CU} \)
- \( \text{(2,000)} \)
- \( \text{(4,000)} \)
- \( \text{(6,000)} \)
- \( 2008 \)
- \( 2009 \)
- \( 2010 \)
- \( 2011 \)
- \( 2012 \)

- Current US GAAP
- FASB 2016 Proposed
4.4 Variable Annuity Segment

4.4.1 Analysis of Field Testing Results

Applying the targeted improvements and their interpretations to valuation of the variable annuity segment resulted in higher and more volatile segment reserves than the reserves under the existing guidance (see Exhibit 4.4.1A). This is mainly due to the market risk benefits liability being recorded at fair market value, as opposed to following SOP 03-1 guidance, with the changes in instrument-specific credit risk spread being recorded in OCI (see Exhibit 4.4.1B). Most of the change in these reserves was related to GMIBs, as opposed to guaranteed minimum death benefits (GMDBs), reflecting the greater market risk associated with GMIBs.

DAC under the targeted improvement showed a higher balance after transition and lower volatility in the asset balance (see Exhibit 4.4.1.D) since under the targeted improvements, DAC amortization is based on policy counts as opposed to more volatile expected gross profits (e.g., expected gross profits in 2011 were slightly high, resulting in a larger write-off during the year).

Pretax income under the targeted improvements was more volatile than under the existing guidance, again reflecting primarily how the fair value of the market risk benefits liability fluctuated over the Study Period due to fluctuation in the discount rates and other market inputs (see Exhibit 4.4.1E). Although the effect of hedge assets was taken into account, these benefits were not fully hedged, and so the impact of discount rates and other market inputs on hedge assets did not offset the entire liability impact. The changes in DAC also affected earnings for 2011 and 2012.

Pretax comprehensive income followed the net income pattern as the changes in instrument-specific credit risk spread noted from the Field Testing were not significant (see Exhibit 4.4.1G). Changes in instrument-specific credit risk spread were, however, somewhat greater in 2008 and 2009, reflective of the economic conditions at the time.
Exhibit 4.4.1A

Net Liability

Exhibit 4.4.1B

Additional liability for guarantees*

* Currently accounted for under SOP 03-1.
Exhibit 4.4.1G

Pretax Comprehensive Income/(Loss)

- Current US GAAP
- FASB 2016 Proposed
5. Additional Key Observations on the Participating Model

The targeted improvements require participating business to be valued under a framework similar to the framework used for non-participating business, namely to discount cash flows based on a portfolio of high-quality, fixed-income instrument yield and to use current best-estimate assumptions to measure future cash flows with changes in those assumptions requiring a retrospective unlocking of the net premium ratio. The application of this approach to participating business would result in three key unintended and undesirable consequences:

- Create an accounting mismatch at issue in measurement of the liability if the liability discount rate is not consistent with the dividend credited rate.
- When determining income, create further accounting mismatches if the interest accretion rate is locked in from issue, while projected cash flows reflect changing economics and a current view of future dividend credited rates.
- When interest rates change, create an inconsistency within the liability valuation depending on whether the net premium ratio is unlocked between the impact of the resulting change in dividend crediting rates on projected cash flows, and the impact of updating the interest accretion rate.

As discussed in Section 4.3, the Field Testing approach, particularly upon transition, muted the impact of these issues on the actual Field Testing results. To better illustrate these points, we developed a simplified example of a participating product and applied the methodology proposed by the targeted improvements. We then illustrate some alternative approaches to address these issues. The sections below summarize the nature of the example, results, and findings.

5.1 Product and Assumptions

The modeled product is a cohort of a single premium five-year participating product. For the purposes of this example, mortality, lapse, and expenses are ignored. Interest rate yield curves are assumed to be level. Additionally, it is assumed that the total asset returns are passed on to the policyholder through annual dividends. For this simplified product, net income is equal to: investment income + net cash flows (including dividends) + change in reserves. Since all the asset returns are passed on to the policyholder, net income and total comprehensive income of zero in all years would be consistent with the economics of the contract, regardless of scenario.

The example illustrates income emergence under two scenarios:

1. Baseline Scenario – Under this scenario, the economic environment does not change over the five-year period. As such, there are no changes to asset earned rates and dividend credited rates for subsequent valuations.
2. Sensitivity Scenario – Under this scenario, interest rates are assumed to suddenly rise in year 2. It is assumed the prescribed liability discount rate based on high-quality fixed-income instrument yield rises by 50 basis points (bps), whereas the actual asset portfolio held by the entity rises by 100 bps. It is assumed the entity's assets are invested in one-year bonds; therefore, the increase in rates is immediately reflected in the asset book yields and passed on to the policyholder in year 3 and onward via a 100-bps increase in the dividend credited rate.

We analyzed income emergence under the two scenarios using the following reserve methodologies:

a. Current proposed guidance – Discount rate is equal to yields on high-quality fixed-income instruments. Interest accretion rate used to determine net income is locked in at issue. In subsequent valuations, cash flows are updated based on current dividend rates. The net premium ratio is updated for changes in cash flows resulting from changes in current dividend rates, but not for changes in interest accretion rates.

b. Alternative #1 – Discount rate is equal to the dividend credited rate, thus achieving consistency between dividend rate and discount rate. Interest accretion rate is locked in at issue. In subsequent valuations, dividend cash flows are updated based on current dividend rates.

c. Alternative #2 – Dividend credited rate for the purposes of projecting cash flows is set equal to the liability discount rate (i.e., high-quality fixed-income instrument yield). This achieves consistency in dividend credited rate and discount rate; however, the projected cash flows do not reflect actual expected dividends to be paid. Interest accretion rate is locked in at issue. In subsequent valuations, dividend cash flows are updated based on changes in the high-quality fixed-income instrument yield.

d. Alternative #3 – Discount rate is equal to the dividend credited rate. In subsequent valuations, dividend cash flows are updated based on current dividend rates. For purposes of calculating net income, the interest accretion rate is updated on subsequent valuations using the effective yield method (i.e., solve for interest accretion rate such that the interest accretion rate – or rates – are consistent with the effective yield on the contract after the change in dividend credited rates, so that the update to dividend credited rate is reflected in OCI). When interest rates change, the changes to interest accretion rates and to dividend credited rates are handled consistently when unlocking the net premium ratio.28

5.2 Results

The tables and graphs below illustrate the income emergence pattern under the baseline scenario and the sensitivity scenario using the various reserve methods.

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28 The change in projected cash flows resulting from the change in credited rates is excluded from unlocking the net premium ratio, consistent with excluding the change in discount rate. Alternatively, the updated interest accretion rate could have been used to discount the updated cash flows when unlocking the net premium ratio.
Baseline Scenario

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<th>Total</th>
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Net Income (Baseline)

Total Comprehensive Income (Baseline)
### Sensitivity Scenario

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<thead>
<tr>
<th>Year</th>
<th>Net Income</th>
<th>Total Comprehensive Income</th>
</tr>
</thead>
<tbody>
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<td></td>
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<td>1 2 3 4 5</td>
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<tr>
<td>Proposed</td>
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<td>Alternative #2</td>
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</tr>
<tr>
<td>Alternative #3</td>
<td>0 0 0 0 0</td>
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</tr>
</tbody>
</table>

#### Net Income (Sensitivity)

- **FASB 2016 Proposed**
- **Alternative #1**
- **Alternative #2**
- **Alternative #3**

#### Total Comprehensive Income (Sensitivity)

- **FASB 2016 Proposed**
- **Alternative #1**
- **Alternative #2**
- **Alternative #3**
5.3 Key Observations

Proposed guidance

The lack of consistency between the dividend credited rate assumption used to project cash flows and the rates used to discount the cash flows (either the locked-in rate for the income statement or the high-quality fixed-income instrument yield for the balance sheet and comprehensive income) leads to a mis-estimation of the liability under the baseline scenario. This can be seen in the year 1 net income of -$35. Since the product in this example is expected to pass on the full asset yields to the policyholder, zero profits are expected over the life of the business. The net income under the proposed approach does have zero total net income over the life of the business; however, the accounting mismatch leads to a temporary loss in year 1 under the baseline scenario, which reverses out with equivalent gains over years 2–5. This is because the liability discount rate is lower than the dividend credited rate over this period.

Under the sensitivity scenario in which interest rates rise at the end of year 2, the effect of this disconnect is evident in both net income and comprehensive income results. The dividend credited rate increases starting in year 3, increasing projected future cash flows, but the interest accretion rate (the discount rate used for liabilities in the income statement; see Glossary) is locked in, causing a mismatch with the assets. This results in an additional temporary loss of -$19 in year 2 since assets decline more than liabilities. Similar to the baseline scenario, this loss, driven by a temporary accounting mismatch, reverses out in future years, resulting in zero total profits over the life of the business. For comprehensive income, the discount rate for the liabilities rises but by only 50 basis points, producing a lower loss of -$5 but still a mismatch. Here again, these temporary losses reverse over time.

Alternative #1 and #2

For Alternative #1 and #2, the liability estimate better reflects the economics of the product due to the consistency between the discount rate and dividend credited rate. This eliminates the temporary gains/losses in net income and total comprehensive income that we observed using the proposed approach under the baseline scenario.

Although, in this simplified example, there is consistency between the discount rate and the dividend credited rate at issue, a disconnect arises when dividend credited rates increase in year 2 due to the interest accretion rate being locked in for net income purposes. This results in a temporary loss in net income of -$27 and -$14 in year 2 for Alternative #1 and #2, respectively. This loss again reverses out in subsequent years. Because the current value of the liability for balance sheet purposes uses a current yield curve for discounting, total comprehensive income is zero in all years, consistent with the economics of the contract.

Alternative #3

Alternative #3 sets the discount rate equal to the dividend credited rate similar to Alternative #1 and, as such, has consistent results under the baseline scenario; however, when rates rise in year 2 under the sensitivity, the interest accretion rate in Alternative #3 is unlocked using an effective yield method. This unlocking of the interest accretion rate eliminates the temporary losses in net income in year 2 and onward. Since the current value of the liability under Alternative #3 is based on current assumptions, there is no impact to equity either, as can be seen in the projected zero total comprehensive income.
In this example, the net premium ratio never changes since the present value of gross premium plus liability is always exactly equal to future benefits. As a result, the approach within the current proposed guidance to unlocking the net premium ratio did not impact the results. Had we shown a more complex example in which the present value of gross premium plus liability did not always exactly equal future benefits, an additional mismatch would have arisen. That would be the mismatch in the current proposed guidance between the treatment of changes in dividend credited rates and the treatment of changes in discount rates within the unlocking of the net premium ratio. This would have generated additional impacts to net income and total comprehensive income inconsistent with the economics. Maintaining consistency between whether both changes in dividend crediting rates and changes in discount rates are included or excluded from the unlocking of the net premium ratio would have eliminated these non-economic impacts.

This example was deliberately simplified to use only 1-year bonds. When there are assets with longer durations, for the balance sheet it is important to discount using current and projected market rates, rather than projected portfolio book rates. Because asset values reflect current market rates, liabilities need to similarly reflect market rates in order to avoid large non-economic fluctuations in GAAP equity.

5.4 Findings and Recommendations

Based on the observations above, we have the following recommendations:

The discount rate needs to be consistent with the current and projected market rates underlying the dividend credited rate. Using a high-quality fixed-income instrument yield to discount liability cash flows is inconsistent with the characteristics of the liability for participating contracts.

When determining net income, the interest accretion rate and the dividend credited rate used for projecting future cash flows need to use an internally consistent approach. If the current best-estimate dividend credited rate is used to determine the projected cash flows, then the interest accretion rate needs to be updated using a “level-spread” approach. Under a level-spread approach, net income is not based on a single interest accretion rate but rather on a set of interest accretion rates that vary by duration in parallel with projected dividend credited rates at each duration. On the other hand, if the interest accretion rate is locked in at inception of the contract, then the projected dividend cash flows used to determine net income must also be based on the dividend credited rate at contract inception. As previously noted, however, this would generate future dividend cash flows that are not truly the best estimate of those cash flows.

When interest rates change, there should be consistent treatment of the resulting impacts within the liability valuation for the following items: (a) the impact of the change in dividend credited rates on projected cash flows and (b) the impact of updating the discount rate. The targeted improvements would unlock the net premium ratio for (a) but not for (b), creating an internal inconsistency within the valuation. Either the changes in cash flows resulting from dividend credited rate changes should be excluded from the change in net premium ratio (consistent with the IASB approach for unlocking the contractual service margin) or the impact of the updated interest accretion rate (per the second bullet above) should be included in the change in net premium ratio.
Although not part of this example, expected policyholder dividends should exclude any projected future dividends arising from profits from other businesses. These additional dividends should be accrued as declared, similar to the way stock companies record shareholder dividends.
6. Definition of non-par discount rate

Discount Rate Sensitivity
In addition to the baseline results, we performed a sensitivity on developing the high-quality fixed-income rate for the purposes of determining the discount rate for the retirement segment. The discount rates were developed as follows:

- For the Baseline scenario, the rate is defined as an AA-rated corporate bond yield graded to 5.75% from year 30 to year 40.

- For the sensitivity scenario (identified as 'spread by year' sensitivity) the rate is defined as an A-rated corporate bond yield, which was estimated as a level-spread increase to the entire baseline scenario discount curve, where the level-spread is updated at each valuation year. The rate graded to an ultimate rate of 6.00% from years 30 to year 40.

We are concerned by the results shown in Exhibits 6.1C and 6.1D showing the impact to OCI and to total comprehensive income based on a AA discount rate and an A discount rate. We expect that the guidance in the ED that traditional contract liabilities should be discounted using a "high-quality fixed-income yield" will be interpreted as requiring a AA rate for USD denominated insurance liabilities. These results indicate that, at least in times of market dislocation, such as was the case in 2008, the AA spread does not provide an adequate illiquidity premium for traditional insurance contracts.

A theoretically correct discount rate for non-participating contracts would start with a replicating portfolio that matches the liability characteristics. The yield on the replicating portfolio assets would need to be reduced by expected default losses as well as a charge for the risk of unexpected defaults. This would be similar to the top down approach that FASB proposed in the 2013 ED.

We understand that FASB does not want to use company-specific discount rates. But in that case the appropriate discount rate should be based on the investments of the industry as a whole, or at least the highly rated insurers within the industry. After all, these insurers sell non-participating insurance contracts every day and invest to match the liability characteristics. So the aggregate fixed-income portfolio of the insurance industry is a useful starting point as to determine what the appropriate discount rate for non-participating contracts should be.

In general, even highly rated insurers typically invest in fixed income instruments that are investment grade, but on average below AA in quality. Generally, the investments of highly rated insurers is between A and BBB. Even after deducting expected default losses and a charge for unexpected defaults, this indicates that the illiquidity premium for non-participating contracts for the insurance industry as a whole is closer to an A spread than a AA spread.

The sensitivity test shown above, based on non-participating insurance contracts issued by 3 large, highly rated insurers, indicate that under at least some market conditions a AA spread is inadequate. Under relatively normal market conditions, such as 2010 through 2012, there is not a large difference between the liability calculated using the AA spread versus the more appropriate A spread. But in 2008, when the financial markets became distorted and illiquid, the spread between A and AA rates increased substantially. In our sensitivity test results, this generated a large difference in other comprehensive income between discounting liabilities using an A spread versus a AA spread. We are concerned that in such markets this impact
could lead to a large decrease in US GAAP equity, or even negative equity. This would be a false signal to investors and perhaps more importantly to regulators who may use US GAAP financial statements as a measure of insurance company solvency. When the financial markets normalized in 2009, the difference between using an A discount rate and a AA discount mostly reversed.

Paragraph 944-40-55-13E permits an insurer to use its own estimates when market data reflects transactions that are not orderly. But given existing GAAP precedent for translating “high-quality fixed-income yield” to mean AA, it is not clear that we would be permitted to use a discount rate other than AA even if a situation like 2008 repeated itself, and markets became disorderly causing AA spread to be significantly different from the true illiquidity premium of traditional insurance contracts.

We therefore recommend changing the language describing the discount rate and/or providing application guidance such that the discount rate used for traditional insurance contracts would represent an A yield for USD denominated liabilities. Alternatively, an appropriate discount rate could be based on an average of NAIC 1 and NAIC 2 yields, or an average of investment grade yields, similar to the proposal currently exposed by the NAIC for discounting single premium immediate annuities.\textsuperscript{29}

If the NAIC principles based reserving (VM-22) exposure is adopted, using a consistent credit quality distribution would result in lower implementation costs for companies and have a transparent discount rate more reflective how insurance companies operate.

\textsuperscript{29} The exposure is available at http://www.naic.org/documents/committees_aлатf_vm22sg_160719_draft_clean.pdf (link as of 10/27/2016).

\textsuperscript{30} The Portfolio Credit Quality Distribution is the rate currently proposed as 5% treasuries, 15% Aa, 40% A, and 40% Baa.
Retirement Segment Sensitivity

Exhibit 6.1A

Reserves - Discount Rate Sensitivity

Exhibit 6.1B

Pretax Income/(Loss) - Discount Rate Sensitivity
7. Retrospective vs. Prospective Unlocking

The FASB targeted improvements require that when cash flow assumptions are updated, the net premium ratio be unlocked using a retrospective approach. The targeted improvements note a revised net premium ratio is to be calculated as of contract inception using actual historical experience and updated projected cash flow assumptions. This approach is complex to implement and produces results that are difficult for users to understand. A similar methodology currently applies to the amortization of DAC for nontraditional life insurance contracts and has led to non-GAAP measures. Below, we have developed an example to illustrate the impact of various approaches for reflecting historical experience and/or a future assumption change. The example shows the impact on income emergence over the life of a block of business where an assumption update occurs midway through the life of the business. The sections below summarize the nature of the product, scenarios modeled, results, and findings.

7.1 Example Product, Assumptions, and Unlocking Method

The business being modeled is a whole life product cohort. The policyholders pay a level annual premium for life and receive a benefit equal to the face amount upon death. For the purposes of the exercise, lapses, surrenders, and expenses are ignored. Net income is equal to: investment income + net cash flows + change in reserves.

The example illustrates income emergence under two scenarios:

1. Baseline Scenario – Under this scenario, mortality experience emerges equal to the anticipated best-estimate assumption at issue. As such, no subsequent assumption updates are required.

2. Sensitivity Scenario – Under this scenario, mortality experience emerges higher than the anticipated best-estimate assumption at issue. The experience is considerably higher in earlier years (approximately 20% higher), tapering down and eventually settling to a 10% increase over the original assumption by year 10. The entity is assumed to monitor the experience for the first 10 years, and then in year 11, when there is enough credible data, the entity unlocks their best-estimate mortality assumption. The entity unlocks the assumption by increasing mortality by 10%. The experience deviations and assumption update are reflected in reserves using the following different methods:

   a. No Update – Assume best-estimate assumption is locked in at issue and not revised in subsequent valuations. This is similar to the current FAS 60 approach.

   b. Full-retrospective Update – Unlock the net premium ratio (K) every year by solving for K at issue such that K x present value of premiums = present value of benefits, where premiums and benefits from issue to the valuation date are based on actual historical cash flows, and cash flows from the valuation date onward are based on projections using the current best-estimate mortality assumption.

   c. Quasi-retrospective Update – Unlock the net premium ratio (K) in year 11 by solving for K at issue such that K x present value of premiums = present value of benefits, where premiums and benefits are projected from issue using the current best-estimate mortality assumption. Unlike the full-retrospective approach, this method applies the
revised assumption retroactively, rather than using actual historical cash flows. This method can be applied for a contract-level calculation, whereas the full-retrospective calculations would require a cohort-level calculation.

d. Prospective Update – Unlock the net premium ratio (K) in year 11 by solving for K as of the valuation date such that the reserve post unlocking is equal to the reserve prior to unlocking.

7.2 Results

The graph above illustrates the income emergence pattern under the baseline scenario and the sensitivity scenario using the various unlocking methods. Key observations of the results are as follows:

1. Baseline Scenario – Experience emerges as expected, as such income also emerges smoothly over the life of the business.

2. Sensitivity Scenario – Mortality experience is higher than the anticipated best-estimate assumption at issue; therefore, the income emergence patterns for all of the different unlocking approaches reflect the lower level of earnings over the life of the business. However, the pattern of the experience deviations in years 1 through 10 and the impact of the assumption unlocking in year 11 are markedly different across the approaches.

a. No Update – Experience deviations flow through income as they arise, leading to income volatility commensurate with experience. This is most notable in years 1 through 10. The reserves are inadequate to cover future benefit payments, which leads to lower income and eventually losses in years 19 and 20.

b. Full-retrospective Update – The full-retrospective approach unlocks the net premium ratio for current-period experience deviations in years 1 through 10. When mortality experience is higher than anticipated in early years, the net premium ratio is unlocked, leading to a lower reserve relative to the no-update approach. As a result, experience deviations are partially smoothed out, resulting in higher income in years 1 through 10. However, upon assumption unlocking in year 11, the excess income realized in prior years needs to be reversed due to the updated mortality outlook, and this results in a large unlocking impact in year 11.
c. Quasi-retrospective Update – Experience deviations in years 1 through 10 flow through income consistent with the no-update scenario since the net premium ratio is not unlocked until prospective assumptions are revised in year 11. Due to the assumption update, there is a sudden reserve increase in year 11, which puts a strain on income. This reserve increase is dampened by the unlocking of the net premium ratio.

d. Prospective Update – The prospective approach solves for a net premium ratio such that the reserve post unlocking is equal to the reserve prior to unlocking, which is equal to the no-update scenario. As such, there is no unlocking impact on reserves nor income in year 11, with results being consistent with the no-update scenario. Unlike the retrospective update approach, there is no smoothing of the actual experience variances prior to year 11. However, unlike the no-update scenario, the projected cash flows are revised in the prospective update unlocking, and years 12 through 20 reflect the increase in reserves resulting from the higher mortality assumption. This causes an income strain in year 12 as reserves are increased. The unlocked reserves also avoid the losses in years 19 and 20 that would have been incurred under the no-update scenario.

7.3 Key Observations

We recommend using prospective unlocking. Unlike the full-retrospective approach, prospective unlocking does not partially smooth out actual experience deviations. Under the prospective approach, the full impact of actual deviations of experience from assumptions is recorded in income immediately. As long as the net premium ratio is below the 100% cap, prospective unlocking provides a greater offset to income when future assumptions change, relative to either retrospective unlocking approach. While not problematic to have full offsets to future assumption changes that do not create a premium deficiency since those assumed changes have not yet occurred, such offsets are more appropriate than offsets to actual experience deviations that have occurred as occur under full-retrospective unlocking.

We also note from experience with FAS 97 DAC amortization that maintaining and updating actual historical results adds substantial cost to retrospective unlocking. Prospective and Quasi-retrospective unlocking both avoid this cost; however, Quasi-retrospective unlocking is essentially a hybrid between prospective and full-retrospective unlocking, without a theoretical basis on its own. Hence, Quasi-retrospective unlocking would essentially be a practical compromise approach.
8. Operational Challenges

The purpose of this section is to provide the FASB with challenges that preparers would face implementing the targeted improvements beyond the specific operational concerns identified within the technical discussion in the sections above.

8.1 Transition Timeline

To adopt the targeted improvements, we expect a minimum of four years is necessary for entities to change, develop, and integrate their operating models and strategic management framework. It would be essential to run parallel processes under the existing standard and to test the efficiency and effectiveness of the new control environment. However, the targeted improvements as modified by our recommendations could be implemented in less time but still would require a minimum of three years.

8.2 Practical Expedients at Transition

Under the targeted improvements, at the beginning of the earliest period presented, an insurance entity would apply the new guidance on the liability for future policyholder benefits retrospectively to all prior periods for each level of aggregation at which reserves are currently calculated. As a practical expedient, if actual historical information covering the entire contract period is not available at the level of aggregation at which reserves are calculated, an insurance entity may use estimates of historical information derived from objective information for those periods in which actual historical information is not available. In those cases, an entity need not undertake exhaustive efforts to obtain objective information but should take into account all objective information that is reasonably available.\(^\text{31}\)

The perceived impracticability threshold is difficult to overcome because it does not take into consideration the level and extent of time, effort, and resources needed. We envision many situations where full-retrospective application may not technically meet the impracticability threshold but, nonetheless, would require substantial time, effort, and resources that would clearly not justify the benefits. As such, we recommend that the Board consider allowing entities to avail themselves of the practical expedients provided when full-retrospective application may technically be practicable but cannot be performed without undue cost and effort (or some other cost/benefit criteria).

As mentioned earlier within this document, retrospective transition for market risk benefits would often be more complex than for traditional contracts issued at the same time because of the need to calibrate and generate stochastic economic scenarios to determine the attributed fee on a market risk benefit. Given the dramatic economic events of the past decade, it would be particularly difficult to calibrate economic scenarios objectively without the use of hindsight.

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\(^{31}\) Proposed paragraph 944.40-65-2D.
8.3 Disclosures Targeted Improvements

Under the targeted improvements, the entities would be required to disclose the following information about the liability for future policy benefits in both interim and annual financial statements:

1. Disaggregated tabular rollforward of the opening balance to the closing balance, with separate presentation of expected future net premiums and expected future benefits

2. For each disaggregated rollforward:
   a. The undiscounted ending balance for both the expected future net premiums and the expected future benefits
   b. The amount of gross premiums recorded
   c. The amount of any related reinsurance recoverable
   d. The weighted-average duration of the liability
   e. Qualitative and quantitative information about significant inputs, judgments, and assumptions used in measuring the liability, including ranges and weighted averages, actual experience during the period, changes to those significant inputs, judgments, assumptions during the period, and the effect of those changes on the measurement of the liability during the period

3. A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount of the liability, and the total interest and gross premiums recorded for the period

4. Qualitative and quantitative information about adverse development that resulted in a charge to current-period benefit expense due to the following:
   a. Net premium ratio exceeding 100%
   b. The establishment of an additional liability for a UL-type contract or investment contract in the current period

5. For contracts for which the entity did not recognize a liability because no future losses are expected, qualitative and quantitative information (which includes the range, weighted average, and actual experience) about the significant inputs, judgments, and assumptions used to conclude no losses are expected

In addition, the entities would disclose the following information about the liability for policyholders' account balances in both interim and annual financial statements:

1. Disaggregated tabular rollforward of the opening balance to the closing balance

2. For each disaggregated rollforward presented:
   a. The weighted-average earned rate and the weighted-average crediting rate
   b. The guaranteed benefit amounts in excess of the current account balances (net amount at risk)
   c. Cash surrender value

\[32\] Proposed paragraph 944-40-50-6.
3. A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount of the liability

4. Tabular presentation of policyholders' account balances by range of guaranteed minimum crediting rates, and the related range of the difference between rates being credited to policyholders and the respective guaranteed minimums

5. Qualitative and quantitative information about objectives, policies, and processes for managing risks, including information about hedging activity undertaken to manage capital market risk

8.3.1 Key Observations

The Field Testing focused on the recognition, measurement, and presentation of insurance contracts as described throughout this Comment Letter. Owing to time and availability of resources, we did not attempt to produce the disclosures required by the targeted improvements. The level of effort required to produce these disclosures within the required filing deadlines should not be underestimated. We recommend that the FASB and interested parties review the proposed disclosure requirements in light of the FASB's own Disclosure Framework project undertaken in order to improve the effectiveness of disclosures.

The FASB has stated that although reducing the volume of the notes to financial statements is not the focus of the project, their hope is that a sharper focus on important information would result in reduced volume in most cases. Similarly, the SEC is also looking at ways to improve disclosure effectiveness in their own project on the topic. The proposed disclosures would add a significant amount in terms of volume and effort to comply, while it is questionable whether all the information is important or useful to users of the financial statements.

Users' needs are very different based on the lines of business that are prominent for any given entity. For example, the information needs of users of financial statements from a property and casualty insurance entity are very different from the information needs of users of financial statements from a life insurance entity. Disclosure requirements tailored to lines of business would create more efficient and effective disclosures than blanket line item requirements that may provide for substantial increase in volume of disclosure but only provide marginal benefits.

In particular, we agree that rollforwards of liabilities provide useful information to users at the appropriate level of disaggregation. Rollforwards at the product level, as viewed by management, would be very useful. A rollforward for each product sold during a calendar quarter would provide a lot of data but would not be significantly more useful.

Disclosures Related to Weighted Average

Disclosure of weighted averages of assumptions used to develop reserves would also not provide meaningful information. Significant inputs included in the reserve calculation include (depending on the product) benefit utilization, withdrawal rates, recovery rates, lapse rates, mortality, reset elections, and equity volatility. It is unclear, for example, how an insurer would perform a weighted average for a mortality or lapse rate assumption that may vary for each projection year for decades across each of several thousand contracts, potentially across multiple countries and currencies. Even if the methods used to compute such amounts are disclosed, the disclosure would not be meaningful and could potentially be misleading.
Also, comparing weighted averages across companies, or even across different products within a single company, is not necessarily meaningful. For example, if Company A has a weighted-average mortality assumption of 2 deaths per thousand and Company B has a weighted average of 2.3 deaths per thousand, it could mean that Company B's assumptions are more conservative, the average age of Company B's policyholders is a little older than Company A's, or that Company A and Company B are each reflecting appropriately the impacts of different product designs, underwriting practices, or sales practices. These various possible explanations also cause the weighted-average disclosure to not be meaningful and instead to possibly be misleading. Instead of the weighted average, the important information about assumptions would be a qualitative description of how actual experience differed from expected and what changes were made to the assumptions.

An issue that may be useful to financial statement users may be how accurately the insurer estimates its assumptions. That would be better revealed by disclosures around the magnitude of the effect of assumption changes such as a table covering several previous years. This would be more feasible and more meaningful than weighted averages or ranges of assumptions.
Appendix A – Types of Insurance Contracts

<table>
<thead>
<tr>
<th>Insurance contract</th>
<th>Characteristics</th>
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</thead>
<tbody>
<tr>
<td>Traditional life insurance contracts (FAS 60)</td>
<td>Traditional life insurance contracts subject the insurer to risks arising from policyholder mortality and morbidity over the period that coincides with the period in which premiums are collected. These contracts provide for a fixed rate of interest over some specified period, with the insurance entity bearing the investment risk associated with the investment assets.</td>
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<tr>
<td>Limited-payment insurance contracts (FAS 97 LP)</td>
<td>Limited-payment contracts are long-duration contracts with terms that are fixed and guaranteed, and for which premiums are paid over a period shorter than the period over which benefits are provided. Limited-payment contracts subject the insurer to risks arising from policyholder mortality and morbidity over a period that extends beyond the period or premiums in which premiums are collected.</td>
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<tr>
<td>UL-type contracts (FAS 97 UL)</td>
<td>The differences between UL-type contracts and other long-duration contracts is that UL-type insurance contracts lack the fixed and guaranteed terms that are typical for other long-duration contracts. Policyholders are frequently granted significant discretion over the amount and timing of premium payments. Insurers are frequently granted significant discretion over amounts that accrue to and that are assessed against policyholders.</td>
</tr>
<tr>
<td>Nontraditional fixed and variable annuity life insurance contracts (FAS 97 UL)</td>
<td>Annuity and life products with nontraditional terms may combine fixed and variable features and are sold as general account or separate account products. The features of such contracts are many and complex, and may be offered in different combinations, such that there are numerous variations of the same basic products being sold in the marketplace.</td>
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<tr>
<td>Participating life insurance contracts (FAS 120)</td>
<td>Mutual life insurance entities primarily issue participating life insurance contracts. Those contracts provide policyholders with certain guaranteed benefits and allow policyholders to share in the experience of the entity through dividends. Dividends are paid periodically and generally reflect the experience and performance of the entity for investment activity, mortality experience, and contract administration for each particular class of contracts. The determination and distribution of dividends distinguish participating life insurance contracts from non-participating life insurance contracts.</td>
</tr>
<tr>
<td>Investment contracts (FAS 97 IC)</td>
<td>These are long-duration contracts that do not subject the insurance entity to risks arising from policyholder mortality or morbidity.</td>
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## Appendix B – Summary of the Targeted Improvements

On September 29, 2016, the FASB issued the exposure draft on proposed targeted improvements to the accounting for long-duration contracts.

This section summarizes the key proposed accounting standards updates issued by the FASB within the exposure draft.

<table>
<thead>
<tr>
<th>Target improvement area</th>
<th>Summary of Targeted Improvements</th>
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</thead>
<tbody>
<tr>
<td>ASC 944-40-35-5: Periodic assumption update</td>
<td>944-40-35-5 Cash flow assumptions shall be updated on an annual basis, at the same time every year, or more frequently in interim reporting periods if actual experience or other evidence suggests that earlier cash flow assumptions should be revised. Discount rate assumptions as of the reporting date shall be updated for annual and interim reporting periods.</td>
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</table>
| ASC 944-40-35-6A: Assumption Update Methods for Traditional Long-Duration Contracts, Limited-Payment Contracts, and Participating Life Insurance Contracts | 944-40-35-6A A related charge or credit to current-period benefit expense or other comprehensive income as a result of updating assumptions at the level of aggregation at which reserves are calculated shall be determined as follows:  
   a. Cash flow assumptions: Cash flow assumptions used to calculate net premiums shall be updated as of the contract issue date using actual historical experience and updated future cash flow assumptions (that is, on a retrospective basis). The revised ratio of net premiums to gross premiums shall be applied retrospectively as of the contract issue date to derive an updated liability for future policy benefits amount, discounted at the original (that is, contract issuance) discount rate. The updated liability for future policy benefits shall then be compared with the carrying amount of the liability for future policy benefits to determine the cumulative catch-up adjustment to be recognized in current-period benefit expense. In subsequent periods, the revised ratio of net premiums to gross premiums, which shall not exceed 100 percent, shall be used to value the liability for future policy benefits, subject to future revisions.  
   b. Discount rate assumptions: Net premiums shall not be updated for discount rate assumption changes. The difference between the carrying amount of the liability for future policy benefits (that is, the present value of future benefits and expenses less the present value of future net premiums) measured using the updated discount rate assumption and the original discount rate assumption shall be recognized directly to other comprehensive income (that is, on an immediate basis). The interest accretion rate shall remain the original discount rate used at contract issue date.  
   c. Experience adjustments: Experience adjustments shall be recognized in the period in which that experience arises. |
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| **ASC 944-40-30-7A and 944-40-35-7A: Premium deficiency and loss recognition** | 944-40-30-7A To the extent the present value of future benefits and expenses exceeds the present value of future gross premiums, an immediate charge shall be recognized to current-period benefit expense such that net premiums are set equal to gross premiums. In no event shall the liability for future policy benefits balance be less than zero. Assumptions shall be updated in subsequent accounting periods as described in paragraphs 944-40-35-5 through 35-7A.  
944-40-35-7A To the extent that the present value of future benefits and expenses exceeds the present value of future gross premiums, an immediate charge shall be recognized to current-period benefit expense such that net premiums are set equal to gross premiums. In subsequent periods (that is, until assumptions are subsequently updated) the liability for future policy benefits shall be accrued with net premiums set equal to gross premiums. In no event shall the liability for future policy benefits balance be less than zero. |
| **ASC 944-40-30-9: Discount rate** | 944-40-30-9 The liability for future policy benefits shall be discounted using a high-quality fixed-income instrument yield. An insurance entity shall consider reliable information in estimating the high-quality fixed-income instrument yield that reflects the duration characteristics of the liability for future policy benefits (see paragraph 944-40-55-13E). An insurance entity shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs in determining the discount rate assumption. |
| **ASC 944-40-30-7 and 944-40-30-15A: Accounting for participating life insurance contracts** | 944-40-30-7 The liability for future policy benefits accrued is the present value of future benefits (including policyholder dividends) to be paid to or on behalf of policyholders and related expenses less the present value of future net premiums (portion of gross premium required to provide for all benefits and expenses, excluding acquisition costs or costs that are required to be charged to expense as incurred). That liability shall be estimated using methods that include assumptions, such as discount, mortality, morbidity, terminations, and expenses, and policyholder dividends (see paragraphs 944-40-30-9 through 30-15A). The liability also shall consider other assumptions relating to guaranteed contract benefits, such as coupons, annual endowments, and conversion privileges. The assumptions shall not include a provision for the risk of adverse deviation.  
944-40-30-15A Policyholder dividend assumptions used in estimating the liability for future policy benefits shall be based on estimates of dividends expected to be paid to policyholders. |
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<tr>
<td>944-30-35-3, 3A, 3B and 3C: Amortization of DAC</td>
<td>944-30-35-3 Capitalized acquisition costs shall be charged to expense using termination or in force assumptions consistent with those used in estimating the liability for future policy benefits (or any other related balance) for the corresponding contracts (see Subtopic 944-40), as applicable. For contracts with accumulation and payout phases, the payout phase shall be viewed as a separate contract under this Topic and shall not be combined with the accumulation phase for amortization of capitalized acquisition costs. 944-30-35-3A Acquisition costs capitalized under paragraphs 944-30-25-1A through 25-1B shall be charged to expense on a ratable basis as follows: a. In proportion to the undiscounted amount of insurance in force over the expected term of the related contract b. On a straight-line basis, if the amount of insurance in force over the expected term of the related contract cannot be reasonably estimated. 944-30-35-3B The balance of capitalized acquisition costs shall be reduced for actual experience in excess of expected experience (that is, as a result of unexpected contract terminations). The effect of changes in future estimates (for example, revisions of mortality or lapse assumptions) shall be recognized in those future periods on a prospective basis as a change in accounting estimate in accordance with paragraph 250-10-45-17. 944-30-35-3C No interest shall accrue to the unamortized balance of capitalized acquisition costs. In determining amortization expense, future contract renewal expenses shall not be included before the incurrence of those costs.</td>
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<td>Target Improvement area</td>
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In addition, as discussed in paragraph 944-40-25-1, a liability for unpaid claims and claim adjustment expenses shall be accrued when insured events occur. For any amounts reclassified from the liability for future policy benefits to the liability for unpaid claims upon the incurrence of a claim, including subsequent adjustments to those amounts, the liability for unpaid claims and claim adjustment expenses shall be discounted as follows:  

a. The interest accretion rate used to discount the liability for future policy benefits shall continue to be applied to the related liability for unpaid claims.  

b. Corresponding amounts recognized in accumulated other comprehensive income as a result of upscaling the discount rate assumption (as described in paragraph 944-40-35-5) shall be carried over and subsequently adjusted for future changes in the discount rate assumption (as described in paragraph 944-40-35-6A(b)).  

**Additional Liability**  
944-40-25-25B This guidance addresses contract features that provide for potential benefits in addition to the account balance as follows:  

a. An insurance entity shall first determine whether such contract features should be accounted for under the provisions of paragraph 944-40-25-25C.  

b. For contract features that are not accounted for under the provisions of paragraph 944-40-25-25C, an insurance entity shall then determine whether such contract features should be accounted for under the provisions of Subtopic 815-10 or 815-15.  

All other contract features shall be accounted for under the provisions of paragraphs 944-40-25-26 through 25-27A.  

**Market Risk Benefits**  
944-40-25-25C A market risk benefit shall be recognized for contracts and benefits that meet both of the following criteria:  

a. Contract: The contract holder has the ability to direct funds to one or more separate account investment alternatives maintained by the insurance entity, and investment performance, net of contract fees and assessments, is passed through to the contract holder. The separate account need not be legally recognized or legally insulated from the general account liabilities of the insurance entity.  

b. Benefit: The insurance entity provides a benefit protecting the contract holder from adverse capital market performance, exposing the insurance entity to other-than-nominal capital market risk. A nominal risk, as explained in paragraph 944-20-15-21, is a risk of insignificant amount or a risk that has a remote probability of occurring. A benefit is presumed to have other-than-nominal capital market risk if the net amount at risk (that is, the guaranteed benefit in excess of the account balance, cash value, or similar amount) varies more than an insignificant amount in response to capital market volatility. Capital market risk includes equity, interest rate, and foreign exchange risk.  

If a long-duration contract contains multiple market risk benefits, those market risk benefits shall be bundled together as a single, compound market risk benefit (consistent with the guidance in paragraph 815-15-25-7).
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<tr>
<th>Target improvement area</th>
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| ASC 944-605-30-2A and 944-605-35-1B: Limited-Payment Contracts DPL | **Limited-Payment Contracts**  
944-605-30-2A Assumptions used in measuring any gross premium deferred in accordance with paragraph 944-605-25-4A (that is, the deferred profit liability) shall be consistent with those used in estimating the liability for future policy benefits as described in paragraph 944-40-35-7.  
944-605-35-1B Cash flow assumptions shall be updated in subsequent accounting periods to determine changes in the deferred profit liability. Cash flow assumptions shall be updated on an annual basis, at the same time every year, or more frequently in interim reporting periods if actual experience or other evidence suggests that earlier cash flow assumptions should be revised. The interest accretion rate shall remain the original discount rate used at contract issue date. A related charge or credit to current-period benefit expense as a result of updating cash flow assumptions shall be determined as follows:  
a. Cash flow assumptions used to calculate the deferred profit liability shall be updated as of the contract issue date using actual historical experience and updated future cash flow assumptions (that is, on a retrospective basis).  
b. The recalculated deferred profit liability as of the contract issue date shall be subsequently amortized in accordance with paragraph 944-605-35-1A to derive the revised deferred profit liability as of the current period.  
c. The revised deferred profit liability calculated in (b) shall be compared with the carrying amount of the deferred profit liability to determine the cumulative catch-up adjustment to be recognized in current-period benefit expense (see paragraphs 944-40-55-13A through 55-13D). |
<table>
<thead>
<tr>
<th>Target improvement area</th>
<th>Summary of Targeted Improvements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASC 944-40-85-2 (c) and (d): Transition – Liability for Future Policyholder Benefits</strong></td>
<td>At the beginning of the earliest period presented (that is, the transition date), an insurance entity shall apply the pending content that links to this paragraph on the liability for future policy benefits by means of retrospective application to all prior periods. For traditional, limited-payment, and participating contracts, an insurance entity shall apply the pending content that links to this paragraph using one of the following methods for each level of aggregation at which reserves are calculated:</td>
</tr>
<tr>
<td><strong>a. Retrospectively to the contract issue date using actual historical information at the level of aggregation at which reserves are calculated:</strong></td>
<td>1. If actual historical information covering the entire contract period is not available at the level of aggregation at which reserves are calculated, an insurance entity may use estimates of historical information derived from objective information for those periods in which actual historical information is not available. In those cases, an entity need not undertake exhaustive efforts to obtain objective information but shall take into account all objective information that is reasonably available. Those estimates of historical experience determined as of the transition date shall be considered actual historical experience for purposes of subsequent adjustments.</td>
</tr>
<tr>
<td><strong>b. If it is impracticable (as described in paragraphs 250-10-45-9 through 45-10) to apply the pending content that links to this paragraph on the liability for future policy benefits retrospectively to the contract issue date at the level of aggregation at which reserves are calculated, an insurance entity shall apply the pending content that links to this paragraph to in force contracts on the basis of their existing carrying amounts at the transition date and by using updated assumptions, adjusted for the removal of any amounts in accumulated other comprehensive income. The transition date carrying amount less the present value of future benefits shall be compared with the present value of future gross premiums to calculate the net premium ratio. The opening balance of retained earnings balance shall be adjusted only to the extent that net premiums exceed gross premiums. The transition date shall be considered the contract issue date for purposes of determining the discount rate assumption at contract inception and for purposes of subsequent adjustments</strong></td>
<td></td>
</tr>
<tr>
<td>Target improvement area</td>
<td>Summary of Targeted Improvements</td>
</tr>
<tr>
<td>-------------------------</td>
<td>---------------------------------</td>
</tr>
</tbody>
</table>
| **ASC 944-40-65-2 (e):** Transition – Market Risk Benefits | *Market risk benefits*
<p>| | At the beginning of the earliest period presented (that is, the transition date), an insurance entity shall apply the pending content that links to this paragraph on market risk benefits by means of retrospective application to all prior periods. The transition adjustment shall be recognized as follows: |
| | a. The cumulative effect of changes in the instrument-specific credit risk between contract issue date and transition date shall be recognized in accumulated other comprehensive income. |
| | b. The difference between fair value and carrying value at the transition date, excluding the amount in (e)(1), shall be recognized as an adjustment to the opening balance of retained earnings. |
| <strong>ASC 944-40-65-2 (b): Transition – DAC</strong> | <em>Deferred acquisition costs</em> |
| | At the beginning of the earliest period presented (that is, the transition date), an insurance entity shall begin to apply the pending content that links to this paragraph on amortization of deferred acquisition costs to the existing carrying amounts at the transition date, adjusted for the removal of any related amounts in accumulated other comprehensive income. That transition method shall apply to all other balances that are amortized on a basis consistent with the amortization of deferred acquisition costs. |</p>
<table>
<thead>
<tr>
<th>Target improvement area</th>
<th>Summary of Targeted Improvements</th>
</tr>
</thead>
</table>
| **ASC 944-40-50-6: Disclosure – Liability for Future Policy Benefits** | *Liability for Future Policy Benefits and Additional Liability for Annuitzation, Death, or Other Insurance Benefits*  
944-40-50-6. For annual and interim reporting periods, an insurance entity shall disclose the following information about the liability for future policy benefits described in paragraphs 944-40-25-10A through 25-11 and the additional liability described in paragraphs 944-40-25-26 through 25-27A as applicable:  
   a. A disaggregated tabular rollforward of the beginning balance to the ending balance (see paragraph 944-40-55-13I). For the liability for future policy benefits, the insurance entity shall present separately in the rollforward expected future net premiums and expected future benefits.  
   b. For each disaggregated rollforward presented:  
      1. The undiscounted ending balance for both the expected future net premiums and the expected future benefits  
      2. The amount of gross premiums recognized in the statement of operations  
      3. The amount of any related reinsurance receivable  
      4. The weighted-average duration of the liability  
      5. Qualitative and quantitative information about the significant inputs, judgments, and assumptions used in measuring the liability, including ranges and weighted averages, actual experience during the period, changes in those significant inputs, judgments, and assumptions during the period, and the effect of those changes on the measurement of the liability during the period.  
   c. A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount of the liability in the statement of financial position, and the total interest and gross premiums recognized in the statement of operations.  
   d. Qualitative and quantitative information about adverse development at the level of aggregation at which reserves are calculated that resulted in a charge to current-period benefit expense due to the following:  
      1. Net premiums exceeding gross premiums in the current period  
      2. The establishment of an additional liability for a universal life Type contract or investment contract in the current period.  
   e. For contracts described in paragraphs 944-40-25-26 through 25-27A for which an entity did not recognize a liability because no future losses are expected, qualitative and quantitative information (that is, the range, weighted average, and actual experience) about the significant inputs, judgments, and assumptions used to conclude that no losses are expected. |
<table>
<thead>
<tr>
<th>Target Improvement Area</th>
<th>Summary of Targeted Improvements</th>
</tr>
</thead>
</table>
| **ASC 944-40-50-7A:** Disclosure – Liability for Policyholders’ Account Balances | 944-40-50-7A For annual and interim reporting periods, an insurance entity shall disclose the following information about the liability for policyholders’ account balances described in paragraph 944-40-25-14 (excluding separate accounts described in paragraph 944-80-25-2):  
   a. A disaggregated tabular rollforward of the beginning balance to the ending balance (see paragraph 944-40-55-13J).  
   b. For each disaggregated rollforward:  
      1. The weighted-average earned rate and the weighted average crediting rate  
      2. The guaranteed benefit amounts in excess of the current account balances  
      3. Cash surrender value  
   c. A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount of the liability for policyholders’ account balances.  
   d. A tabular presentation of policyholders’ account balances by range of guaranteed minimum crediting rates, and the related range of the difference between rates being credited to policyholders and the respective guaranteed minimums.  
   e. Qualitative and quantitative information about objectives, policies, and processes for managing risks, including information about hedging activity undertaken to manage capital market risk. |
| **ASC 944-40-50-7B:** Disclosure – Market Risk Benefits | Market Risk Benefits  
944-40-50-7B For annual and interim reporting periods, an insurance entity shall disclose the following information about market risk benefits  
   a. A disaggregated tabular rollforward of the beginning balance to the ending balance, disaggregated further by type of market risk benefit (see paragraph 944-40-55-13K).  
   b. For each disaggregated rollforward:  
      1. The guaranteed benefit amounts in excess of the current account balances (for example, for variable annuity contracts, the net amount at risk).  
      2. Qualitative and quantitative information about the methods, significant inputs, judgments, and assumptions used in measurement, including ranges and weighted averages, actual experience during the period, changes during the period, and the effect of those changes on the measurement during the period.  
   c. A reconciliation of the disaggregated rollforwards to the aggregate ending carrying amount, disaggregated between positions that are in an asset position and those that are in a liability position.  
   d. Qualitative and quantitative information about objectives, policies, and processes for managing risks arising from market risk benefits, including information about hedging activity undertaken to manage capital market risk. |
<table>
<thead>
<tr>
<th>Target improvement area</th>
<th>Summary of Targeted Improvements</th>
</tr>
</thead>
</table>
| **ASC 944-80-50-2: Disclosure – Separate Account Liabilities** | 944-80-50-2 For annual and interim reporting periods, an insurance entity shall disclose the following information about separate account liabilities described in paragraph 944-80-25-2:  
  a. A disaggregated (in accordance with paragraph 944-40-50-5A) tabular rollforward of the beginning balance to the ending balance  
  b. For each separate account liability rollforward presented, the related cash surrender values  
  c. A reconciliation of the separate account liability rollforwards to the aggregated ending carrying amount of the liability. |
| **ASC 944-30-50-2A: Disclosure – Deferred Acquisition Costs** | 944-30-50-2A For annual and interim reporting periods, an insurance entity shall disclose the following:  
  a. The nature of acquisition costs capitalized  
  b. A tabular rollforward of the beginning to the ending balance of unamortized deferred acquisition costs, disaggregated in a manner that is consistent with the disaggregation of the related liability disclosures (see Section 944-40-50)  
  c. Qualitative and quantitative information about the inputs, judgments, assumptions, and methods used to determine amortization amounts. |
| **ASC 944-40-65-2 (f): Disclosure – Transition-Related Disclosures** | Transition disclosures  
An insurance entity shall provide the following disclosures in the year of adoption:  
  a. Information required in paragraphs 250-10-50-1 through 50-3 on a disaggregated basis consistent with that which will be used for recurring disclosures (see paragraphs 944-40-55-13F through 55-13H)  
  b. If retrospective application is impracticable, the portion of the liability for future policy benefits at the transition date not subject to retrospective application  
  c. Qualitative and quantitative information about transition adjustments related to:  
    1. Net premiums exceeding gross premium  
    2. The establishment of an additional liability for a universal life-type or an investment contract. |
Appendix C – Questions for Respondents

The chart below provides a summary for how the Group considered certain aspects of the questions within the targeted improvements.

<table>
<thead>
<tr>
<th>Question</th>
<th>Group's views and responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liability for Future Policy Benefits – Contracts Other Than Participating Contracts</td>
<td></td>
</tr>
<tr>
<td>Question 1 – Scope: Do you agree with the scope of the proposed amendments on the accounting for the liability for future policy benefits for contracts other than participating contracts? If not, what types of contracts, contract features, or transactions should be included in or excluded from the scope, and why?</td>
<td>Not field tested.</td>
</tr>
<tr>
<td>Question 2 – Cash flow assumption update method and presentation: Do you agree that the effect of updating cash flow assumptions should be calculated and recognized on a retrospective basis in net income? If not, what other approach or approaches do you recommend, and why?</td>
<td>See Section 7.</td>
</tr>
<tr>
<td>Question 3 – Cash flow assumption update frequency: Do you agree that cash flow assumptions should be updated on an annual basis, at the same time every year, or more frequently if actual experience or other evidence indicates that earlier assumptions should be revised? If not, what other approach or approaches do you recommend, and why?</td>
<td>Not field tested</td>
</tr>
<tr>
<td>Question 4 – Discount rate assumption: Do you agree that expected future cash flows should be discounted on the basis of a high-quality, fixed-income instrument yield that maximizes the use of current market observable inputs? If not, what other approach or approaches do you recommend, and why?</td>
<td>See Section 6.</td>
</tr>
<tr>
<td>Question</td>
<td>Group’s views and responses</td>
</tr>
<tr>
<td>----------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>Question 5 – Discount rate assumption update method and presentation: Do you agree that the effect of updating discount rate assumptions should be recognized immediately in OCI? If not, what other approach or approaches do you recommend, and why?</td>
<td>See Executive Summary, Section 3 and Section 4.</td>
</tr>
<tr>
<td>Question 6 – Discount rate assumption update frequency: Do you agree that discount rate assumptions should be updated at each reporting date? If not, what other approach or approaches do you recommend, and why?</td>
<td>Not field tested.</td>
</tr>
</tbody>
</table>

**Liability for Future Policy Benefits – Participating Contracts**

<p>| Question 7 – Scope (participating contracts): Do you agree with the scope of the proposed amendments on the accounting for the liability for future policy benefits for participating contracts, including closed block contracts issued by a demutualized insurance entity? If not, what types of contracts, contract features, or transactions should be included in or excluded from the scope, and why? | See Executive Summary and Section 3. |
| Question 8 – Cash flow assumption update method and presentation (participating contracts): Do you agree that the effect of updating cash flow assumptions should be calculated and recognized on a retrospective basis in net income? If not, what other approach or approaches do you recommend, and why? | See Section 7. |</p>
<table>
<thead>
<tr>
<th>Question</th>
<th>Group’s views and responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 9 — Cash flow assumption update frequency (participating contracts): Do you agree that cash flow assumptions should be updated on an annual basis, at the same time every year, or more frequently if actual experience or other evidence indicates that earlier assumptions should be revised? If not, what other approach or approaches do you recommend, and why?</td>
<td>See Section 7.</td>
</tr>
<tr>
<td>Question 10 — Discount rate assumption (participating contracts): Do you agree that expected future cash flows should be discounted on the basis of a high-quality fixed-income instrument yield that maximizes the use of current market observable inputs? If not, what other approach or approaches do you recommend, and why?</td>
<td>See Section 7.</td>
</tr>
<tr>
<td>Question 11 — Discount rate assumption update method and presentation (participating contracts): Do you agree that the effect of updating discount rate assumptions should be recognized immediately in OCI? If not, what other approach or approaches do you recommend, and why?</td>
<td>See Section 7.</td>
</tr>
<tr>
<td>Question 12 — Discount rate assumption update frequency (participating contracts): Do you agree that discount rate assumptions should be updated at each reporting date? If not, what other approach or approaches do you recommend, and why?</td>
<td>Not field tested.</td>
</tr>
<tr>
<td>Question</td>
<td>Group's views and responses</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Market Risk Benefits</strong></td>
<td></td>
</tr>
<tr>
<td>Question 13 – Scope: Do you agree with the scope of the proposed amendments on the accounting for market risk benefits? If not, what types of contracts or contract features should be included in or excluded from the scope, and why?</td>
<td>See Section 3.2.</td>
</tr>
<tr>
<td>Question 14 – Measurement: Do you agree that all market risk benefits should be measured at fair value, with fair value changes attributable to a change in the instrument-specific credit risk recognized in OCI? If not, what other alternative or alternatives do you recommend, and why?</td>
<td>See Section 3.2.</td>
</tr>
<tr>
<td><strong>Deferred Acquisition Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Question 15 – Scope: Should the scope of the proposed amendments be expanded to include investment contract acquisition costs currently amortized using the interest method in Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs?</td>
<td>Not field tested.</td>
</tr>
<tr>
<td>Question 16 – Amortization: Do you agree with the proposed amendments that would simplify the amortization of DAC? If not, what other simplified and reasonably estimable amortization approach or approaches do you recommend, and why?</td>
<td>See the Executive Summary and Section 3 and Section 4.</td>
</tr>
<tr>
<td>Question 17 – Impairment: Do you agree that DAC should not be subject to impairment testing? If not, what alternative or alternatives do you recommend, and why?</td>
<td>See the Executive Summary and Section 3.</td>
</tr>
<tr>
<td>Question</td>
<td>Group's views and responses</td>
</tr>
<tr>
<td>----------</td>
<td>----------------------------</td>
</tr>
<tr>
<td><strong>Presentation and Disclosure</strong></td>
<td></td>
</tr>
<tr>
<td>Question 18 – Proposed requirements: Do you agree that the presentation and disclosure requirements included in the proposed amendments would provide decision-useful information? If not, which presentation and/or disclosure requirement or requirements would you change, and why?</td>
<td>See Section 8.3.</td>
</tr>
<tr>
<td>Question 19 – Additional requirements: Are there any additional presentation or disclosure requirements that would provide decision-useful information? If so, please describe them and explain why.</td>
<td>See Section 8.3.</td>
</tr>
<tr>
<td><strong>Effective Date and Transition</strong></td>
<td></td>
</tr>
<tr>
<td>Question 20 – Implementation date: The Board is interested in understanding the key drivers affecting the timing of implementation. What are those key drivers, and how do they affect the time it will take to implement the proposed amendments? Should the effective date be the same for both public entities and nonpublic entities?</td>
<td>See Section 8.1.</td>
</tr>
<tr>
<td>Question 21 – Transition methods: Are the proposed transition provisions operable, and do they provide decision-useful information? If not, what would you recommend, and why?</td>
<td>See Section 8.2.</td>
</tr>
<tr>
<td>Question 22 – Transition disclosure: Do the proposed transition disclosure requirements provide decision-useful information? If not, what would you recommend, and why?</td>
<td>See Section 8.2.</td>
</tr>
<tr>
<td>Question</td>
<td>Group's views and responses</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>Costs and Complexities</td>
<td></td>
</tr>
<tr>
<td>Question 23 – Costs and complexities: Describe the nature of the incremental costs of adopting the proposed amendments, distinguishing between one-time costs and ongoing costs. Explain which aspects of the proposed amendments are driving those costs and include ideas to make the proposals more cost effective.</td>
<td>See Executive Summary.</td>
</tr>
</tbody>
</table>
Appendix D – Rollforward of Insurance Liability, Assets, and Margins by Product Segment

Traditional Segment*

<table>
<thead>
<tr>
<th>Traditional Segment Rollforward of Insurance Liability (CU)</th>
<th>31 December 2008</th>
<th>31 December 2009</th>
<th>31 December 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying amount beginning of period</td>
<td>-</td>
<td>-</td>
<td>17,874</td>
</tr>
<tr>
<td>Premiums Received</td>
<td>10,484</td>
<td>-</td>
<td>10,484</td>
</tr>
<tr>
<td>Benefits/Expenses Paid</td>
<td>-</td>
<td>(5,738)</td>
<td>-</td>
</tr>
<tr>
<td>New Business</td>
<td>(6,287)</td>
<td>6,593</td>
<td>306</td>
</tr>
<tr>
<td>Indorse True up and Assumption Unlocking, Deferred Profit Release and Experience Adjustment</td>
<td>(3,395)</td>
<td>3,174</td>
<td>(224)</td>
</tr>
<tr>
<td>Interest Accrued</td>
<td>(1,997)</td>
<td>2,785</td>
<td>788</td>
</tr>
<tr>
<td>Change in discount rates</td>
<td>-</td>
<td>-</td>
<td>993</td>
</tr>
<tr>
<td>Carrying amount end of period</td>
<td>-</td>
<td>-</td>
<td>24,483</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Traditional Segment Additional Disclosure Requirements (CU)</th>
<th>31 December 2008</th>
<th>31 December 2009</th>
<th>31 December 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undiscounted Ending Balance</td>
<td>(119,497)</td>
<td>206,153</td>
<td>86,656</td>
</tr>
</tbody>
</table>

* Rollforward split between net premiums and net benefits was not available for this segment due to data availability issues as part of the Field Testing.
## Traditional Segment

### Rollforward of Insurance Liability (CU)

<table>
<thead>
<tr>
<th></th>
<th>31 December 2011</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying amount beginning of period</td>
<td>41,163</td>
<td>54,727</td>
</tr>
<tr>
<td>Premiums Received</td>
<td>14,194 (14,194)</td>
<td>15,463 (15,463)</td>
</tr>
<tr>
<td>Benefits/Expenses Paid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Business</td>
<td>11,291 (11,107)</td>
<td>11,742 (11,742)</td>
</tr>
<tr>
<td>Inforce True up and Assumption Unlocking, Deferred Profit Release and Experience Adjustment</td>
<td>496 (1,006)</td>
<td>635 (220)</td>
</tr>
<tr>
<td>Interest Accreted</td>
<td>4,843 (4,843)</td>
<td>5,776 (5,776)</td>
</tr>
<tr>
<td>Change in discount rates</td>
<td>- (8,012)</td>
<td></td>
</tr>
<tr>
<td>Carrying amount end of period</td>
<td>54,727</td>
<td>7,885</td>
</tr>
</tbody>
</table>

## Traditional Segment

### Additional Disclosure Requirements (CU)

<table>
<thead>
<tr>
<th></th>
<th>31 December 2011</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undiscounted Ending Balance</td>
<td>127,456 (230,647)</td>
<td>161,787 (231,440)</td>
</tr>
<tr>
<td>Expected Future Net Premiums</td>
<td>358,103</td>
<td>393,227</td>
</tr>
<tr>
<td>Expected Future Benefits</td>
<td>127,456</td>
<td>161,787</td>
</tr>
<tr>
<td>Total Balance</td>
<td>161,787</td>
<td>161,787</td>
</tr>
<tr>
<td>-------------------------</td>
<td>-------------</td>
<td>-------------</td>
</tr>
<tr>
<td>Carrying amount beginning of period</td>
<td>9,516</td>
<td>10,083</td>
</tr>
<tr>
<td>Capitalizations</td>
<td>1,710</td>
<td>2,295</td>
</tr>
<tr>
<td>Total amortization of DAC</td>
<td>(1,143)</td>
<td>(1,202)</td>
</tr>
<tr>
<td>Carrying amount end of period</td>
<td>10,083</td>
<td>11,176</td>
</tr>
</tbody>
</table>
## Retirement Segment

### Retirement Segment Retrursor of Insurance Liability (C\$)

<table>
<thead>
<tr>
<th></th>
<th>31 December 2008</th>
<th></th>
<th>31 December 2009</th>
<th></th>
<th>31 December 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PV of Future Net</td>
<td>PV of Future Net</td>
<td>Total</td>
<td>PV of Future Net</td>
<td>PV of Future Net</td>
</tr>
<tr>
<td></td>
<td>Premiums</td>
<td>Benefits/Claims</td>
<td>Insurance</td>
<td>Premiums</td>
<td>Benefits/Claims</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Liability</td>
<td></td>
<td>Liability</td>
</tr>
<tr>
<td>Carrying amount</td>
<td>(18,013)</td>
<td>41,227</td>
<td>24,214</td>
<td>(22,753)</td>
<td>52,529</td>
</tr>
<tr>
<td>beginning of period</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premiums Received</td>
<td>3,200</td>
<td>-</td>
<td>3,200</td>
<td>3,969</td>
<td>-</td>
</tr>
<tr>
<td>Benefits/Expenses</td>
<td>-</td>
<td>(2,449)</td>
<td>(2,449)</td>
<td>-</td>
<td>(2,808)</td>
</tr>
<tr>
<td>Paid</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Business</td>
<td>(12)</td>
<td>2,265</td>
<td>2,254</td>
<td>(387)</td>
<td>2,820</td>
</tr>
<tr>
<td>Infers True up,</td>
<td>(6,993)</td>
<td>6,470</td>
<td>(522)</td>
<td>(4,777)</td>
<td>3,876</td>
</tr>
<tr>
<td>Assumption Unlocking,</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Release of Deferred</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit Liability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>and Experience</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjustment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Accrued</td>
<td>(910)</td>
<td>2,349</td>
<td>1,438</td>
<td>(1,165)</td>
<td>2,841</td>
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<tr>
<td>Change in discount</td>
<td>(26)</td>
<td>1,667</td>
<td>1,641</td>
<td>(2,014)</td>
<td>3,328</td>
</tr>
<tr>
<td>rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Carrying amount</td>
<td>(22,753)</td>
<td>52,529</td>
<td>29,776</td>
<td>(27,047)</td>
<td>62,594</td>
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<tr>
<td>end of period</td>
<td></td>
<td></td>
<td></td>
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### Retirement Segment Additional Disclosure Requirements (C\$)

<table>
<thead>
<tr>
<th></th>
<th>31 December 2008</th>
<th></th>
<th>31 December 2009</th>
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<th>31 December 2010</th>
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<tbody>
<tr>
<td></td>
<td>Expected Future</td>
<td>Expected Future</td>
<td>Total</td>
<td>Expected Future</td>
<td>Expected Future</td>
</tr>
<tr>
<td></td>
<td>Net Premiums</td>
<td>Benefits</td>
<td>Balance</td>
<td>Net Premiums</td>
<td>Benefits</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Undiscounted Ending</td>
<td>(39,008)</td>
<td>144,357</td>
<td>105,349</td>
<td>(42,996)</td>
<td>163,169</td>
</tr>
<tr>
<td>Balance</td>
<td></td>
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</table>
### Retirement Segment Rollforward of Insurance Liability

<table>
<thead>
<tr>
<th></th>
<th>31 December 2011</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying amount beginning of period</td>
<td>(33,528)</td>
<td>77,182</td>
</tr>
<tr>
<td>Premiums Received</td>
<td>5,361</td>
<td>-</td>
</tr>
<tr>
<td>Benefits/Expenses Paid</td>
<td>-</td>
<td>(3,473)</td>
</tr>
<tr>
<td>New Business</td>
<td>674</td>
<td>1,612</td>
</tr>
<tr>
<td>Inforce True up, Assumption Unlocking, Release of Deferred Profit Liability and Experience Adjustment</td>
<td>(7,354)</td>
<td>5,149</td>
</tr>
<tr>
<td>Interest Accreted</td>
<td>(1,491)</td>
<td>3,706</td>
</tr>
<tr>
<td>Change in discount rates</td>
<td>(2,494)</td>
<td>13,073</td>
</tr>
<tr>
<td>Carrying amount end of period</td>
<td>(38,832)</td>
<td>97,249</td>
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### Retirement Segment Additional Disclosure Requirements

<table>
<thead>
<tr>
<th></th>
<th>31 December 2011</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undiscounted Ending Balance</td>
<td>(54,061)</td>
<td>199,942</td>
</tr>
<tr>
<td>----------------------------</td>
<td>-------------</td>
<td>-------------</td>
</tr>
<tr>
<td>Rollforward of Deferred Acquisition Costs (CU)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Carrying amount beginning of period</td>
<td>2,433</td>
<td>2,969</td>
</tr>
<tr>
<td>Capitalizations</td>
<td>727</td>
<td>736</td>
</tr>
<tr>
<td>Total amortization of DAC</td>
<td>(191)</td>
<td>(236)</td>
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<tr>
<td>Carrying amount end of period</td>
<td>2,969</td>
<td>3,499</td>
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</table>
Participating Segment**

** For the purposes of maintaining anonymity, we are not able to present the rollforward for the participating segment in a format consistent with the other segments.

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<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Carrying amount beginning of period</td>
<td>3,531</td>
<td>4,090</td>
<td>4,500</td>
<td>4,986</td>
<td>5,492</td>
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<tr>
<td>Capitalizations</td>
<td>735</td>
<td>652</td>
<td>745</td>
<td>842</td>
<td>600</td>
</tr>
<tr>
<td>Total amortization of DAC</td>
<td>(176)</td>
<td>(242)</td>
<td>(259)</td>
<td>(336)</td>
<td>(352)</td>
</tr>
<tr>
<td>Carrying amount end of period</td>
<td>4,090</td>
<td>4,500</td>
<td>4,986</td>
<td>5,492</td>
<td>5,740</td>
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### Variable Annuity Segment

<table>
<thead>
<tr>
<th>Rollforward of Insurance Liability</th>
<th>Market Risk Benefits (CUL)</th>
<th>PV of Future Fees</th>
<th>PV of Future Claims</th>
<th>Total Insurance Liability PV of Market Risk</th>
<th>PV of Future Fees</th>
<th>PV of Future Claims</th>
<th>Total Insurance Liability PV of Market Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying amount beginning of period</td>
<td>(829) 1,151 1,962</td>
<td>(4,255) 7,354 6,076</td>
<td>(2,124) 4,616 2,392</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Fees Collected</td>
<td>66 66 76 76</td>
<td>155 155</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess Benefits Paid</td>
<td>0 0 0 0</td>
<td>0 0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Business</td>
<td>(570) 1,805 1,213</td>
<td>(401) 627 176</td>
<td>(366) 374 8</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inforce TnA up and Assumption Unlocking</td>
<td>137 3,238 3,375</td>
<td>(498) (2,950) (3,448)</td>
<td>(30) (132) (180)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tae-up (Experience Adjustment)</td>
<td>0 0 0 0</td>
<td>0 0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Accrued</td>
<td>31 79 48</td>
<td>43 262 219</td>
<td>25 39 34</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in discount rates</td>
<td>132 1,314 1,181</td>
<td>157 629 772</td>
<td>179 504 326</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in own credit spreads</td>
<td>146 (1,067) 931</td>
<td>(132) 442 311</td>
<td>62 89 27</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Carrying amount end of period</td>
<td>(928) 7,754 8,019</td>
<td>(7,125) (4,518) 2,392</td>
<td>(2,638) 5,347 2,967</td>
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<td></td>
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<td></td>
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</tbody>
</table>

91
<table>
<thead>
<tr>
<th>Variable Annuity Segment Rollforward of Insurance Liability Market Risk Benefits (CU)</th>
<th>31 December 2011</th>
<th>31 December 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PV of Future Fees</strong></td>
<td><strong>PV of Future Claims</strong></td>
<td><strong>Total Insurance Liability- FV of Market Risk</strong></td>
</tr>
<tr>
<td>Carrying amount beginning of period</td>
<td>(2,639)</td>
<td>5,247</td>
</tr>
<tr>
<td>Fees Collected</td>
<td>185</td>
<td>*</td>
</tr>
<tr>
<td>Excess Benefits Paid</td>
<td>-</td>
<td>(137)</td>
</tr>
<tr>
<td>New Business</td>
<td>(669)</td>
<td>974</td>
</tr>
<tr>
<td>Inforce True up and Assumption Unlocking</td>
<td>258</td>
<td>1,763</td>
</tr>
<tr>
<td>True-up (Experience Adjustment)</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Interest Accreted</td>
<td>(22)</td>
<td>46</td>
</tr>
<tr>
<td>Change in discount rates</td>
<td>(353)</td>
<td>1,899</td>
</tr>
<tr>
<td>Change in own credit spreads</td>
<td>59</td>
<td>(210)</td>
</tr>
<tr>
<td>Carrying amount end of period</td>
<td>(3,201)</td>
<td>9,582</td>
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</table>
### Variable Annuity Segment
#### Rollforward of Deferred Acquisition Costs (CU)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying amount beginning of period</td>
<td>1,760</td>
<td>2,008</td>
<td>2,214</td>
<td>2,367</td>
<td>2,652</td>
</tr>
<tr>
<td>Capitalizations</td>
<td>472</td>
<td>390</td>
<td>353</td>
<td>494</td>
<td>300</td>
</tr>
<tr>
<td>Total amortization of DAC</td>
<td>(224)</td>
<td>(184)</td>
<td>(200)</td>
<td>(210)</td>
<td>(222)</td>
</tr>
<tr>
<td>Carrying amount end of period</td>
<td>2,008</td>
<td>2,214</td>
<td>2,367</td>
<td>2,652</td>
<td>2,730</td>
</tr>
</tbody>
</table>

### Variable Annuity Segment
#### Deferred Inducement Costs (CU)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying amount beginning of period</td>
<td>323</td>
<td>385</td>
<td>408</td>
<td>420</td>
<td>421</td>
</tr>
<tr>
<td>Capitalizations</td>
<td>99</td>
<td>56</td>
<td>49</td>
<td>39</td>
<td>14</td>
</tr>
<tr>
<td>Total amortization of DAC</td>
<td>(38)</td>
<td>(33)</td>
<td>(37)</td>
<td>(38)</td>
<td>(36)</td>
</tr>
<tr>
<td>Carrying amount end of period</td>
<td>385</td>
<td>408</td>
<td>420</td>
<td>421</td>
<td>398</td>
</tr>
</tbody>
</table>
Appendix E – Glossary

Terms used in this Comment Letter

Attributed fee – Also referred to as “ascribed fee.” This is the amount of fee attributed to certain embedded derivatives or market risk benefits at contract inception such that the fair value of the embedded derivative or market risk benefit at inception is equal to zero.

Bps – Basis points.

CU – Currency unit.

DPL – Deferred Profit Liability – Gross premium in excess of net premium that is deferred for limited-payment contracts.

GMDB – Guaranteed minimum death benefit.

GMIB – Guaranteed minimum income benefit.

The Group (or “our” or “we”) – Manulife, MetLife Inc., New York Life and Prudential Financial, Inc.

Interest Accretion Rate – The rate (or rates) used to discount future cash flows to calculate a liability whose change is reported in net income. This rate (or rates) determines the interest that increases the liability that is reported in net income each period.

Level-Spread Approach – The level-spread approach is an approach to determining interest accretion rates for a contract whose credited rates may vary over time. Under the level-spread approach, a set of interest accretion rates is determined such that the interest accretion rates are parallel to the dividend interest credited rates projected for each duration.

LTC – Long-term care contracts.

Retrospective unlocking – Method by which cash flow assumptions used to calculate the net premium ratio are updated as of the contract issue date using actual historical experience and updated future cash flows assumptions.

RI – Retirement Income contracts.

SPIA – Single premium immediate annuity contracts.

Study Period – The period from 31 December 2007 through 31 December 2012, for which the Group performed the Field Testing.

Tenor – The amount of time left for the repayment of a loan or fixed-income security or the initial term length. Tenor can be expressed in years, months, or days.

Term – Term life contracts.

US GAAP – US Generally Accepted Accounting Principles.

VA – Variable annuity contracts.

WL – Whole life contract, can be participating (par) or non-participating (non-par).
Appendix F – Detailed Methodology and Approach

The following table represents detailed methodology and approach for field testing results described in Section 3 and shown in Section 4.

<table>
<thead>
<tr>
<th>Traditional life segment</th>
<th>Whole life</th>
<th>Term</th>
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<tbody>
<tr>
<td><strong>Key actuarial assumptions applicable to product</strong></td>
<td>Current best-estimate assumptions at time of valuation for mortality, lapse, etc. FASB – Acquisition costs as defined by ASU 2010-26</td>
<td>Current best-estimate assumptions at time of valuation for mortality, lapse, etc. FASB – Acquisition costs as defined by ASU 2010-26</td>
</tr>
<tr>
<td><strong>Methodology</strong></td>
<td>Net premium ratio based on average of 2009, 2010, and 2011 new business net premium ratio</td>
<td>Net premium ratio used for transition based on average of post-2007 cohorts</td>
</tr>
<tr>
<td><strong>Transition</strong></td>
<td>Discount Rate – weighted-average discount rate based on 2002–2007 in force</td>
<td>Discount rate – weighted-average discount rate based on pre-2007 cohorts</td>
</tr>
<tr>
<td><strong>Changes in Assumption</strong></td>
<td>Retrospective (Baseline) – revised net premium ratio and updated k-factor for DPL</td>
<td>Retrospective (Baseline) – revised net premium ratio</td>
</tr>
<tr>
<td></td>
<td>Prospective (Sensitivity) – revised net premium ratio and k-factor for DPL to set assumptions impact to zero</td>
<td>Prospective (Sensitivity) – revised net premium ratio to set assumptions impact to zero</td>
</tr>
<tr>
<td><strong>Discount Rate</strong></td>
<td>AA Corporate bond graded to 5.75% in years 30 to 40</td>
<td></td>
</tr>
<tr>
<td><strong>DAC</strong></td>
<td>Amortized over the face amount of the policies in force</td>
<td>Amortized over the policy count</td>
</tr>
<tr>
<td><strong>Practical Expedients Used</strong></td>
<td>DAC – Expected future deferrals were assumed to equal actuals.</td>
<td>Cohorts – For purposes of the Field Testing, the cohorts were not tracked separately due to granularity limitations.</td>
</tr>
<tr>
<td></td>
<td>Retrospective (Baseline) – Actual cash flows were split based on expected cash flows by issue year.</td>
<td>Yield curves were blended to set new business impact to zero for new combined cohort each year.</td>
</tr>
<tr>
<td>Retirement segment</td>
<td>Topic</td>
<td>Retirement income</td>
</tr>
<tr>
<td>--------------------</td>
<td>-------</td>
<td>-------------------</td>
</tr>
<tr>
<td>Key actuarial assumptions applicable to product</td>
<td>Current best-estimate assumptions at time of valuation for mortality, lapse, etc.</td>
<td>Current best-estimate assumptions at time of valuation for mortality, lapse, etc.</td>
</tr>
<tr>
<td>FASB – Acquisition costs as defined by ASU 2010-26</td>
<td>FASB – Acquisition costs as defined by ASU 2010-26</td>
<td>FASB – Acquisition costs as defined by ASU 2010-26</td>
</tr>
<tr>
<td>Change in Assumptions</td>
<td>Retrospective (Baseline) – revised net premium ratio</td>
<td>Retrospective (Baseline) – revised net premium ratio</td>
</tr>
<tr>
<td>Prospective (Sensitivity) – revised net premium ratio to set assumptions impact to zero</td>
<td>Prospective (Sensitivity) – revised net premium ratio to set assumptions impact to zero</td>
<td>Prospective (Sensitivity) – projected cash flows updated with new assumptions; DPL amortization updated for current period based on post-unlocking change in reserve</td>
</tr>
<tr>
<td>Discount Rate</td>
<td>Baseline – AA Corporate bond yield graded to 5.75% in years 30 to 40. Sensitivity – A Corporate bond yield graded to 6% in years 30 to 40; represents a 25-bps increase to the entire baseline yield curve.</td>
<td></td>
</tr>
<tr>
<td>DAC</td>
<td>Amortized over the policy count</td>
<td>Amortized over premium</td>
</tr>
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</table>
**Retirement segment**

<table>
<thead>
<tr>
<th>Topic</th>
<th>Retirement income</th>
<th>LTC</th>
<th>SPIA</th>
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</thead>
<tbody>
<tr>
<td><strong>Practical Expedients Used</strong></td>
<td>DAC – Expected future deferrals were assumed to equal actuals.</td>
<td>Cohorts – For purposes of the Field Testing, the cohorts were not tracked separately due to granularity limitations.</td>
<td>Transition – DPL and DAC were estimated at transition due to not being readily available under current US GAAP.</td>
</tr>
<tr>
<td></td>
<td>Retrospective – Actual cash flows were split based on expected cash flows by issue year.</td>
<td>Transition discount rate – 1996 curve was used for in-force business issued between 1993 and 1994 due to data limitations.</td>
<td>Retrospective – Actual cash flows were split based on expected cash flows by issue year.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>DAC – Premiums were used as proxy for policy count for amortization, and adjustments to DAC amortization were not made for actual vs. expected in-force experience. This is due to inability to break out actual in-force differences vs. premium rate increase activity for purposes of the Field Testing.</td>
<td>DAC – Benefit payments were used as a proxy for policy count for amortization purposes.</td>
</tr>
</tbody>
</table>

**Participating Segment**

<table>
<thead>
<tr>
<th>Topic</th>
<th>ULSG</th>
<th>Par WL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Key actuarial assumptions applicable to product</strong></td>
<td>Current best-estimate assumptions at time of valuation for mortality, lapse, crediting rates, etc.</td>
<td>Current best-estimate assumptions at time of valuation for mortality, lapse, and dividend scale, etc.</td>
</tr>
<tr>
<td></td>
<td>FASB – Acquisition costs as defined by ASU 2010-26</td>
<td>FASB – Acquisition costs as defined by ASU 2010-26</td>
</tr>
<tr>
<td><strong>Methodology</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Transition</strong></td>
<td>No changes at transition as DAC, unearned revenue, and SOP 03-1 balance equal to current US GAAP.</td>
<td>Net premium ratio – average of post-2007 cohorts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Discount rate – weighted-average discount rate based on pre-2007 cohorts</td>
</tr>
<tr>
<td><strong>Change in Assumptions</strong></td>
<td>Base reserve is account value; not applicable.</td>
<td>Retrospective (Baseline) – revised net premium ratio</td>
</tr>
<tr>
<td></td>
<td>SOP 03-1 is unlocked; same as current US GAAP.</td>
<td>Prospective (Sensitivity) – revised net premium ratio to set assumptions impact to zero</td>
</tr>
<tr>
<td><strong>Discount Rate</strong></td>
<td>Reserve is based on the account value. SOP 03-1 is based on the current credited rate.</td>
<td>AA Corporate bond graded to 5.75% in years 30 to 40</td>
</tr>
<tr>
<td><strong>DAC</strong></td>
<td>Amortized over the policy count</td>
<td>Amortized over the policy count</td>
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### Participating Segment

<table>
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<th>Par WL</th>
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<tbody>
<tr>
<td>Practical Expedients Used</td>
<td>Cohorts were not tracked separately due to data limitations.</td>
<td>Cohorts were not tracked separately due to granularity limitations.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Yield curve was blended to set new business impact to zero for new combined cohort each year.</td>
</tr>
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### Variable annuity segment

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<th>Variable annuities</th>
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</thead>
<tbody>
<tr>
<td>Key actuarial assumptions applicable to product</td>
<td>Current best-estimate assumptions at time of valuation for mortality, lapse, etc.</td>
</tr>
<tr>
<td></td>
<td>FASB - Acquisition costs as defined by ASU 2010-26</td>
</tr>
<tr>
<td>Methodology</td>
<td></td>
</tr>
<tr>
<td>Transition</td>
<td>Attributed fee is established at transition based on observed attributed fees for post-2007 cohorts (Variable Annuity Product 1).</td>
</tr>
<tr>
<td></td>
<td>Attributed fee is established at cohort level within a portfolio to eliminate any gain or loss at inception (Variable Annuity Product 2).</td>
</tr>
<tr>
<td></td>
<td>FAS 157 (ASC 820) became effective on 1/1/2008.</td>
</tr>
<tr>
<td></td>
<td>Risk margin and instrument-specific credit risk spread are not applied before 2008.</td>
</tr>
<tr>
<td>Change in Assumptions</td>
<td>Risk margin, attributed fee, and instrument-specific credit risk spread are added to revise the calculation from SOP 03-1 to FAS 133 (ASC 815)/FAS 157 (ASC 820).</td>
</tr>
<tr>
<td>Discount Rate</td>
<td>Current risk-free rate and instrument-specific credit risk spread</td>
</tr>
<tr>
<td>DAC</td>
<td>Amortized over the policy count</td>
</tr>
</tbody>
</table>

#### Practical Expenditures

**Variable Annuity (Product 1)**

- Attributed fee is solved for each cohort at issue, so the fair value reserve is equal to the SOP 03-1 reserve under current US GAAP at the end of the year of issue.
- Risk margin is a proxy based on FAS 133 risk margin.
- Instrument-specific credit risk spread is the same as that for the FAS 133 riders.

**Variable Annuity (Product 2)**

- At transition the attributed fee was estimated based on the company's profitability target at the time. Attributed fee is established at cohort level within a portfolio to eliminate any gain or loss at inception.
- Risk margin is approximated in aggregate based on other runs performed by company. Instrument-specific credit risk spread is the same as what is used for valuing FAS 133 riders.

**DAC**

- All deferrable sales inducements in a year were associated with the cohort issued that year.
- The amortization was based on maintenance expenses, as a proxy for policy count. All deferrable expenses in a year were associated with the cohort issued that year.