December 15, 2016

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO BOX 5116
Norwalk, CT 06856-5116

Re: Exposure Draft – Proposed Accounting Standards Update
   Financial Services – Insurance (Topic 944)
   Targeted Improvements to the Accounting for Long-Duration Contracts
   File Reference No. 2016-330

Prudential Financial, Inc. (the “Company”) appreciates the opportunity to provide comments on the above referenced Proposed Accounting Standards Update relating to long-duration insurance contracts (the “Exposure Draft” or “ED”). Prudential Financial is a financial services leader with approximately $1.3 trillion of assets under management at September 30, 2016. The Company’s insurance businesses, which primarily offer life insurance and annuities plus other products, are industry leaders in the United States and Asia with approximately $3.5 trillion of gross life insurance in force worldwide as of December 31, 2015. Accordingly, we are keenly interested in the FASB’s work in developing targeted improvements to the current insurance accounting standards that appropriately reflect the economics of the business.

In developing our comments on the proposed insurance standard, we focused on the following three objectives, which we believe must be achieved before considering any changes to current U.S. GAAP. To be considered targeted improvements, any such changes should:

1. Better reflect financial results that correspond to the economics of the insurance business and how it is priced and actively managed;
2. Be cost effective to operationalize, especially when weighed against the benefits to be derived by the user communities; and
3. Result in financial statements that are more relevant, transparent and understandable to users and enhance comparability among issuers.

We support the FASB’s efforts in proposing certain targeted improvements to accounting for long-duration insurance contracts. In general, we agree with the following proposals:

- Simplifying the amortization of Deferred Acquisition Costs (DAC);
• Addressing the accounting diversity for guaranteed living benefit riders on variable annuities, which has created large differences in liability valuations for products with similar economics (as noted in our October 25, 2013 comment letter, we believe the diversity in practice is regrettable under the current standards but would be inexcusable in the “new” world);
• Utilizing Other Comprehensive Income (OCI) to reflect the financial impact of required updates to current discount rates for traditional insurance contract liabilities;
• Requiring the updating of cash flow assumptions to be performed at least annually (same time each year) rather than the previously proposed requirement to update these assumptions in the fourth quarter; and
• Providing certain practical expedients to implement the transition to the new proposed accounting.

However, we have serious concerns that the ED does not fully achieve the three objectives outlined above. In particular, we believe that critical enhancements are required in the following areas to address certain shortcomings:

▪ Definition of non-participating discount rates;
▪ Accounting for Variable Contract Guaranteed Minimum Death Benefits (GMDBs);
▪ Retrospective vs. Prospective unlocking of cash flow assumptions;
▪ Accounting for Closed Blocks formed upon Demutualization;
▪ Transition Methods; and
▪ Relevance and Appropriateness of Disclosures.

We would be very supportive of the proposed standard if the above concerns are addressed and appropriate consideration is given to the tradeoffs between costs, both implementation and ongoing, and the benefits to users of the financial statements.

In providing comments on the ED, the Company has considered, among other things: (1) the modeling the Company performed collectively as part of the Group Field Testing – a collective effort involving Manulife, MetLife, New York Life, and Prudential Financial (“the Group”) as further described in Comment Letter No. 1; (2) reviews of the proposed ED with each of our key insurance businesses and corporate centers including actuarial, finance, and investor relations, and (3) discussions with various companies within the insurance industry. While the work we have performed to date is informative, it has been limited and it is clear to us that more detailed and extensive field testing is required, given the far reaching nature and potentially significant financial impacts of the “targeted improvements” proposed in the exposure draft, to more fully understand the ED’s implications.

We have expanded on our view of the required critical enhancements below, more fully documenting the nature of our primary concerns under the captions of the relevant objectives we believe should be achieved in making targeted improvements to the accounting for long-duration contracts. Additional thoughts are included in the detailed responses to the ED’s specific questions in the attached appendix.

1. Better reflect financial results that correspond to the economics of the insurance business and how it is priced and actively managed

The life insurance business model is premised on satisfying obligations to customers which generally extend over a significant period of time, and in responsibly managing assets to fulfill
those obligations. Given the critical inter-relationship between assets and liabilities in the pricing and management of long-duration life insurance liabilities, we believe it is essential that the ED recognize the economic significance of this relationship. Central to our business model is Asset Liability Matching (“ALM”) whereby we manage assets such that funds will be available at the time needed to make benefit payments to customers. This ALM management is a core tenet to life insurance and a common industry practice.

However, as currently drafted, the ED will result in accounting volatility that does not reflect the underlying ALM economics of how we manage the business, as the liabilities will be discounted at rates unrelated to the assets used to satisfy them resulting in valuation differences. This is contradictory to the underlying economics of the life insurance business model, wherein insurance products are priced based on investment earnings and investment risk assumptions, among other assumptions, and the present value of future insurance obligations takes into account the expected investment returns and risk. We believe that volatility in the financial statements recorded within comprehensive income is only appropriate when it is economically driven. To provide for this result, we believe the proposed modifications to the ED outlined below would result in a better reflection of the economics of our insurance products after giving appropriate recognition to our pricing and ALM processes:

- **Discount Rates for Traditional Non-Participating Contracts:** Under the current proposal, cash flows for traditional non-participating contracts would be discounted at a “high quality fixed income instrument yield.” This language has been interpreted in other areas of existing GAAP as referring to AA or higher rated securities. We acknowledge the strong desire to maximize the use of relevant observable inputs; however, we believe the discount rate used to measure the insurance contract liability should be reflective of the rates implicit in the pricing of the business and the economics behind ALM management. Further, using a AA rate which is generally lower than the rate implicit in the pricing of the business would result in a loss at contract issue (“day 1 loss”) for products in highly competitive institutional markets and for other products. Additionally, use of the AA rate for insurance contracts, while continuing to use a pricing rate for investment contracts, as will continue to be required under existing U.S. GAAP, will result in inconsistent, and therefore less transparent, accounting for products with similar economics (e.g. structured settlements accounted for as either insurance contracts or investment contracts have similar cash flow characteristics and are commingled for ALM management). Similar inconsistencies would emerge between Guaranteed Interest Contracts and insurance contracts with similar cash flow attributes. We are concerned that these inconsistencies could lead to product and transactional designs that could exploit these accounting differences.

We are also concerned that measuring the liability at rates disconnected from both the implicit rates in the pricing and rates needed to achieve appropriate ALM management will lead to inaccurate interpretations of financial results and decrease user understandability. For example, the recognition of a day 1 loss on business we expect to be profitable does not provide for relevant information. As another example, for regulatory bodies that may use U.S. GAAP-based financial information as a measure of insurance company solvency, an uneconomic discount rate applied to liabilities can
provide significantly misstated available capital and non-economic volatility due to the inherent mismatch between insurance liabilities and the assets supporting them producing misleading results in stressed conditions, such as in 2008. During that period, there was a major dislocation in the markets that caused asset credit spreads to significantly widen driving declines in assets values. Under the proposed targeted improvements, a corresponding decrease in related liabilities would not have occurred due to the usage of the AA rate, thus causing a significant non-economic impact in accumulated other comprehensive income (AOCI). While, in contrast, rates implicit in pricing would have moved more in tandem with the change in asset yields. In addition, artificially low discount rates inappropriately lengthen the duration of liabilities, which adds economic costs to the ALM management process (e.g. additional hedging costs associated with matching asset and liability durations).

Given the business model described above, we believe that the current U.S. GAAP definition for discount rates (per ASC 944), i.e., based on expected investment yields, best reflects the way insurance contracts are priced and managed. We agree with updating to current rates on a quarterly basis, however, such updates should still be based on existing U.S. GAAP guidance. Additional transparency could be gained by requiring a disclosure comparing the best estimate yields to a benchmark yield, e.g. a single A rate.

In contrast to the proposed guidance, we believe other more optimal solutions would be, for example, to use a representative portfolio or single A rate in balancing the need for maximizing observable inputs and to better reflect the economics of the business. The response to Question 4 in Appendix A provides further elaboration of our concerns and suggested solutions for your consideration. We welcome the opportunity to work with the FASB to find a solution to this important topic.

- **Accounting for Variable Contract Guaranteed Minimum Death Benefits (GMDBs):** We appreciate the FASB’s recommendations to eliminate the existing diversity in practice related to the accounting for certain living benefit riders on variable annuity products, which in the past created large differences in valuation between companies resulting from nuances in product design rather than from the underlying economics of the products.

We urge the Board to exclude GMDBs from its targeted improvements. We were surprised to see them scoped into targeted improvements given that there currently is consistency in how the industry accounts for this feature. While the impact of capital markets on the amount of death benefits ultimately paid is considered economic, capital markets volatility is less relevant since the payments are not made unless the insured dies, i.e., the insurance risk component triggering the guarantees for GMDBs is much more significant than for living benefit riders, e.g., GMIWBs/GMWBLs. In that respect, hedging capital markets risks for GMDBs are less critical than for living benefit riders and thus, we view it more akin to other universal life-type contracts, i.e. non-variable contracts, with significant death benefit features (as described under ASC 944-40-25-27A and ASC 944-40-30-20).
We are concerned that under a fair value model, best estimate insurance related assumptions require additional risk margins (somewhat akin to Provisions for Adverse Deviations/PADs) as opposed to an insurance model which is based on best estimates without PADs. This anomaly would create non-economic reductions to retained earnings upon transition.

Accordingly, we believe GMDBs should be excluded from the scope of targeted improvements.

2. **Be cost effective to operationalize, especially when weighed against the benefits to be derived by the user communities**

   • *Retrospective vs Prospective Unlocking of Cash Flow Assumptions:* The proposed targeted improvements require that when cash flow assumptions are updated, the net premium ratio for traditional insurance products be unlocked using a retrospective approach. A revised net premium ratio is to be calculated as of contract inception using actual historical experience and updated future cash flow assumptions.

   While we agree that the periodic unlocking of cash flow assumptions is an improvement to the existing model and provides for more relevant information, the retrospective approach is complex and costly to implement and maintain. The retrospective approach also produces results that are difficult for users to understand, and therefore, runs contrary to the principles of transparency and user understandability. For example, a negative retrospective unlocking could cause a user to incorrectly infer that a business is not profitable rather than simply less profitable than the prior estimate. A similar methodology currently applies to the amortization of DAC for Universal Life contracts and has led to significant confusion when analyzing financial results as well as the usage by some companies of non-GAAP measures which exclude the retrospective adjustment to provide improved usability. We acknowledge that there are many more inputs related to the current DAC amortization methodology that causes confusion. That said, comparisons of significant financial impacts from updating the net premium ratios is problematic within a company or between companies. The same degree of assumption or experience changes can generate significantly different current period financial impacts when applied to newer or more mature blocks of business, thereby adding to complexity and lack of transparency. Additionally, the prospective approach provides results that are more in line with the approach to be included in the soon to be issued IFRS 17, Insurance Contracts. As such, the retrospective approach could put U.S. GAAP based companies at a competitive disadvantage with international insurers.

   Accordingly, we recommend using the prospective unlocking approach for updating cash flows. In addition to addressing the concerns noted directly above, we feel there are good theoretical grounds for applying this approach including:

   ✓ The prospective method fully reflects the financial impacts of actual activity differing from previous estimates in net income in the period it emerges, while the retrospective method partially amortizes those
variances. For example, the prospective method would more faithfully reflect a pandemic event.

✓ We believe that changes in assumptions impacting future activity is best reported in net income when the actual activity materializes and could actually be different from previous estimates. The prospective method accomplishes this objective.

✓ We believe these updates in cash flow assumptions can be analogized to certain mortgage-backed and asset-backed securities where the effective yield is adjusted prospectively for any changes in estimated cash flows.

✓ Given that a significant portion of business has inforce that is older than 20 years, the prospective method will most probably need to be applied at transition due to impracticability; therefore, use of the prospective method would provide for greater consistency between inforce at transition and new business post transition.

We agree that disclosures regarding changes in the net premium ratios and the financial impact implications of those changes are critical. We believe that the utilization of prospective unlocking for changes in assumptions about the future, coupled with appropriate disclosures regarding the financial implications of changes in net premium ratios, addresses the user community concerns regarding out of date assumptions in the current model. In addition, we believe the prospective method along with appropriate disclosures also achieves the goal of providing meaningful information about the amount, timing and uncertainty of cash flows related to these contracts.

- **Accounting for Closed Blocks formed upon Demutualization:** For participating contracts within closed blocks formed upon demutualization, regulators require that the insurer set aside a specific pool of assets (closed block assets) that is intended to be sufficient to pay all expected policyholder benefits and expenses, as well as to fund policyholder dividend expectations. Current accounting used to determine the liability for future policyholders’ benefits for contracts within closed blocks is the same as for similar participating policies that are not part of the closed block; however, an additional policyholder dividend obligation (PDO) liability is also established. Assumptions used in determining the liability for future policyholders’ benefits are based on contractual guarantees and thus, effectively “locked-in”. If experience materializes differently than expected, the PDO would be adjusted. In general, the PDO gets adjusted when results, including investment results, are different from the glide path surplus targets determined at demutualization (which is the expected earnings pattern as of the inception of the closed block against which regulators monitor statutory earnings emergence). The expected dividend payments represent a very significant portion of the closed blocks’ expected cash outflows. In extreme scenarios, the insurer can reduce dividends to zero. Given the flexibility to significantly adjust dividends to policyholders, under a going concern assumption, closed blocks operate very similarly to a large commingled separate account with an implicit guarantee from shareholders, albeit with any impact expected to be remote, for underlying contractual guarantees.
Given the operation of closed blocks, as described above, we strongly disagree with including closed blocks in targeted improvements, as proposed for participating policies in the exposure draft, since it would generate undue complexity and significant operational costs for run-off contracts with little benefit to the user community. We recommend that either closed blocks be scoped out as a targeted improvement and thus continue to be subject to loss recognition testing (with added disclosures comparing reported liabilities to loss recognition testing results) or consider the alternatives described in the Executive Summary of Comment Letter No. 1 “Life Insurer Comments on Field Testing of the FASB Proposed Accounting Standards Update of Targeted Improvements to the Accounting for Long-Duration Contracts.”

- **Transition:**

  We recommend greater flexibility in utilizing a prospective approach. We are particularly concerned that, if GMDBs remain in scope for targeted improvements, measuring the attributed fee for GMDBs at transition would be impracticable. In order to determine a practical transition methodology, we believe further deliberations should be addressed by a Transition Resource Group (TRG).

3. **Result in financial statements that are relevant, transparent and understandable to users and enhance comparability among issuers**

- **Relevance and Appropriateness of Disclosures:**

  We agree that liability roll forwards within an operating segment can provide useful information to users assuming the appropriate level of aggregation. However, we believe that:

  - Disclosures of weighted averages related to insurance assumptions do not provide meaningful information to users. The level of disaggregation that would be needed in order for the ranges to be useful would be unmanageable. We believe sensitivity information and providing insights into actual vs. expected experience regarding these assumptions are more meaningful.

  - The DAC disclosures at a segment level are not necessary for interim financial reporting. Given the simplification of accounting for DAC should reduce volatility and create a more predictable amortization pattern, we believe quarterly disclosures at the segment level would not add a significant benefit to the user.

  - The level for disclosing earned rates and credited rates as proposed is not appropriate, since it may lead to the disclosure of proprietary information. We are not aware of any other industry that is required to disclose such information at that level of detail.

  - An additional requirement for disclosures that provide for information related to the adequacy of loss recognition margins (based on the existing GAAP definition for loss recognition testing), disaggregated at the appropriate level, would provide
users with valuable insight into the underlying economics of insurance contracts, including the recoverability of DAC.

Included in Appendix A are the detailed responses to some of the questions posed in the Exposure Draft which specifically relate to the concerns identified above. We appreciate the opportunity to comment on the Exposure Draft and hope that you take our comments under consideration. Should you have any questions or desire further clarification on any of the matters discussed in this letter or the appendix, please contact Robert Boyle, Deputy Controller, at (973) 802-2220, or me at (973) 802-3555.

Sincerely,

Robert D. Axel
Senior Vice President and Corporate Controller

Enclosed – Appendix A
APPENDIX A

FASB’s Exposure Draft for Targeted Improvements to the Accounting for Long Duration Insurance Contracts – Responses to Questions

Retrospective Unlocking – FAS 60/97LP

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?

Answer: We agree.

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?

Answer: We disagree with a retrospective unlock approach. We believe that prospective unlocking would better suit users of financial statements and be more practical to implement. We recommend the prospective method for unlocking for the following reasons:

1. It would improve comparability of income across companies and enforce blocks.
2. Assumption changes would not cause “catch-up” adjustments, reducing volatility and increasing comparability.
3. The retrospective method might encourage use of non-GAAP measures as a way of eliminating the “noise” of the retrospective adjustment.
4. Transition will be simplified compared to the retrospective method and would be comparable to the proposed treatment for DAC.
5. The impact of experience variances (i.e. difference between actual and expected cash flows) will be fully recognized in the period in which it actually occurs.
6. Implementing the prospective method would be less of a strain on existing valuation infrastructure and control procedures.

Below we amplify the above points, assessing the two methods from the point of view of comparability of income, implementation, non-GAAP measures, uneconomic volatility, and transition.

Comparability of income

Retrospective: The retrospective method partially defers the impact of experience variances into future periods. It also results in a “catch-up” adjustment that represents an allocation of changes in future assumptions to amounts that would have been charged in the past had the updated assumptions been used. The relative impact of these two effects on income depends on the age of the block, and would not be comparable from policy block to policy block within a company or between companies. The same degree of assumption or experience change will result in a different impact from block to block. We also note that since it is natural for companies to observe trends in experience before changing assumptions about the future, it is likely that emerging below/above expected experience will be partially deferred in periods leading up to an
assumption update only to be reversed in a later period as part of the “catch-up” adjustment for assumption changes.

- **Prospective:** The prospective method cleanly separates the impact of experience updates and assumption updates, thus enhancing comparability. In any given accounting period, variance in insurance cash flows is fully recognized. Changes in profitability related to assumption changes are allocated to periods after the assumption change rather than to historical periods which vary by policy block, thus improving comparability of results between companies.

**Implementation**

- **Retrospective:** In contrast to FAS97UL products, the valuation of FAS60 products is generally set up on a policy-by-policy basis. To support regularly updating reserves to reflect lapse or mortality experience, procedures and controls to track and update experience at meaningful aggregations (e.g. cohorts) would need to be developed. The processing would be similar to the cohort processing required for retrospective unlocking of DAC FAS97 calculations. The FASB would in effect be eliminating complicated calculations that currently support DAC unlocking, while introducing them into the valuation of FAS60/97LP products.

- **Prospective:** Implementing the prospective method will require a change in valuation system coding, as the net-to-gross ratio must be solved for in order to take account of the level of reserve at the end of the previous period. Although the change in controls and testing necessary to do this should not be underestimated, the logic involved is relatively simple to understand and review, and is similar to GAAP approaches that use the “defined initial reserves method”.

**Non-GAAP measures**

- **Retrospective:** As in the case of the retrospective method for updating DAC, the difficulty of interpreting “catch-up” and experience updates may lead to non-GAAP measures and management discussion in financial reporting, further complicating comparability.

**Volatility of income**

- **Retrospective:** Although this method dampens the impact of experience variances, catch-up adjustments associated with changes in assumptions can produce volatility in income which depends on the age of the block, and is difficult to compare from company to company.

- **Prospective:** The prospective method allows experience variances to flow through income in the period they occur but avoids catch-up adjustments. Overall, income would be less volatile under this approach.

**Transition**

- **Retrospective:** As the FASB recognizes, companies may need to take different approaches at transition due to lack of experience data. This could exacerbate the problem of comparability of unlocking results. Companies which “pivot” from the transition date on certain blocks will have different results for the same degree of experience or assumption update compared to companies
which fully or partially incorporate historical information. These differences will persist well into the future as in force slowly runs off.

- **Prospective**: Transition would be simplified as it is no more difficult than implementing the method. It is also compatible with the pivot method used for DAC.

Based on the above, we recommend the prospective method as the superior option.

**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?

**Answer**: We agree.

**Discount Rate (AA Rate)**

**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?

**Answer**: We do not agree that a “high quality fixed income instrument yield”, which has been interpreted as referring to AA or higher rated securities, is the appropriate discount rate to be used. Our concerns with the current proposal for the liability discount rate are as follows:

- **Loss at issue**: Using a AA rate which is generally lower than the rate implicit in the pricing of the business would result in a loss at contract issue (“day 1 loss”) for products in highly competitive institutional markets and for other products. This is inconsistent with general principles of accrual accounting.

- **Consistency with similar liabilities - debt**: The current proposal is inconsistent with the borrowing costs for many insurance companies. If an insurance company issued debt at rates below AA, they would not incur a loss at the time of the transaction, but would rather appropriately incur interest expense over time.

- **Consistency with similar liabilities accounted for as financial instruments**: The current proposal is also inconsistent with the accounting for certain investment contracts which may have similar characteristics. For example, the structured settlements insurance product may or may not have life contingencies. These liabilities would generally be housed in the same investment portfolios, and would be managed and distributed the same way. However, contracts with life contingencies are accounted for as insurance contracts, whereas contracts without life contingencies are accounted for as financial instruments. The proposed discount rate of AA would drive an increased divergence between the financial impacts for these two very similar liabilities, adding complexity and decreasing transparency.

We recommend one of the following approaches:

- **Representative portfolio**: Use a representative portfolio, similar to the NAIC proposal, as described below.
For U.S. Statutory insurance accounting, the appropriate discount rate to be used for long duration liabilities, specifically fixed annuities, is also being discussed by the National Association of Insurance Commissioners (NAIC) as they work to implement principles-based reserving. They have proposed the following for discounting single premium immediate annuities and similar products:

- Use a representative portfolio that consists of 5% Treasuries, 15% AA-rated Corporate bonds, 40% A-rated Corporate bonds, and 40% BBB-rated Corporate bonds.
- Include a reduction of investment expenses and moderately adverse defaults (CTE 70).
- The NAIC will publish the representative portfolio rate quarterly.

Use of a representative portfolio would increase consistency and transparency by using the same discount rate for all companies. This would reduce the burden on companies by allowing reliance on the publicly available rates published by the NAIC. This would more intuitively have earnings emerge over time based on actual vs. expected investment performance rather than having the potential for an unintuitive day 1 loss. This would increase the consistency between the asset and liability sides of the balance sheet relative to the current proposal by having less divergence between changes in spreads on the asset portfolio and changes in the discount rates on liabilities, as the representative portfolio would be more similar to an average insurance company’s own investment portfolio.

- A-rated Corporate public bonds: Use a simplification of the representative portfolio by using A-rated Corporate public bond rates. This has similar benefits to the representative portfolio compared to the current proposal in terms of consistency and transparency. Compared to the representative portfolio, using A-rated Corporate public bond rates would benefit from being simpler than the representative portfolio. While it would lead to less consistency between the asset and liability sides of the balance sheet compared to the use of a representative portfolio, it would create greater consistency in comparison to the use of a AA rate.

- Pricing spread: This particular proposal directly addresses our concerns regarding day 1 losses. At contract issuance, calculate the pricing spread of the liability relative to single A yield rates by calculating the spread on top of single A yields such that there is no gain or loss at issue. Each period, revalue the liability using the locked in spread plus single A rates. The benefits of this approach include having no gain/loss at issue, having liability rates that are independent of the company’s specific asset investment strategy, having the same discount rate for any issuing insurer for a liability with the same price, and having earnings emerge over the lifetime of the contract without a large day 1 loss.

To illustrate the benefits of the above recommendations, please refer to Attachment 1 on page 21 for an example of how earnings would emerge for a structured settlement product with and without life contingencies under these different approaches. Lastly, additional consideration may be needed for non-USD liabilities.
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 other comprehensive income? If not, what other approach or approaches do you recommend and why?

Answer: We agree.

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?

Answer: We agree.

Changes to Participating Contracts

NOTE: Our comments in this section below are focused on closed block contracts formed upon demutualization. For other traditional participating products, please refer to the Executive Summary of Comment Letter No. 1 “Life Insurer Comments on Field Testing of the FASB Proposed Accounting Standards Update of Targeted Improvements to the Accounting for Long-Duration Contracts”.

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?

Answer: We do not agree. We are very concerned by the inclusion of closed block contracts formed upon demutualization in targeted improvements.

Closed blocks are comprised of a defined, limited group of contracts and a defined specific pool of assets that is sufficient to pay all expected policyholder benefits and expenses, as well as to fund policyholder dividend expectations. Current accounting used to determine the liability for future policyholders’ benefits for contracts within closed blocks is the same as for similar participating policies that are not part of the closed block; however, an additional policyholder dividend obligation (PDO) liability is also established. Assumptions used in determining the liability for future policyholders’ benefits are based on contractual guarantees and thus, effectively “locked-in”. If experience materializes differently than expected, the PDO would be adjusted. In general, the PDO gets adjusted when results, including investment results, are different from the glidepath (the expected earnings pattern as of the inception of the closed block against which regulators monitor statutory earnings emergence) surplus targets determined at demutualization. The expected dividend payments represent a significant portion of the closed block expected cash outflows. In extreme scenarios, the insurer can reduce dividends to zero. Given the flexibility to significantly adjust dividends to policyholders, under a going concern assumption, the closed block operates very similarly to a large commingled separate account with an implicit guarantee from shareholders, albeit expected to be remote, for underlying contractual guarantees.
Given the operation of the closed block, as described above, we feel strongly that including the closed block in targeted improvements would generate undue complexity and significant operational costs for run-off contracts with little benefit to the user community. We recommend that either the closed block be scoped out as a targeted improvement and thus continue to be subject to loss recognition testing (with disclosures comparing reported liabilities to loss recognition) or consider the alternatives described in the Executive Summary of Comment Letter No. 1 “Life Insurer Comments on Field Testing of the FASB Proposed Accounting Standards Update of Targeted Improvements to the Accounting for Long-Duration Contracts.”

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?

Answer: We do not agree. Please refer to our response to Question 7.

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?

Answer: We do not agree. Please refer to our response to Question 7.

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?

Answer: We do not agree. Please refer to our response to Question 7.

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 other comprehensive income? If not, what other approach or approaches do you recommend and why?

Answer: We do not agree. Please refer to our response to Question 7.

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?

Answer: We do not agree. Please refer to our response to Question 7.
**Market Risk Benefits**

**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?

**Answer:** We agree, with a certain exception, with the scope of the proposed amendments for market risk benefits. By the definition of Market Risk Benefits (i.e. variable products with guarantees in separate accounts and similar funds) as stated in the proposed amendments, the following benefit features associated with our variable annuity and/or variable universal life products would be included: (1) Guaranteed Minimum Death Benefits (GMDB), (2) Guaranteed Minimum Income Benefits (GMIB), (3) Guaranteed Minimum Accumulation Benefits (GMAB), (4) Guaranteed Minimum Withdrawal Benefits (GMWB) and (5) Guaranteed Minimum Income and Withdrawal Benefits (GMIWB/GMWBL). We believe GMIB, GMAB, GMWB, and GMIWB/GMWBL possess similar market risks and should be valued consistently under the proposed fair value measurements.

However, we urge the board to exclude GMDBs from the scope of the proposed amendments. While the impact of capital markets on the amount of death benefits ultimately paid is considered economic, capital markets volatility is less relevant since the payments are not made unless the insured dies, i.e., the insurance risk component triggering the guarantees for GMDBs are much more significant than for living benefit riders, e.g., GMIBs. In that respect, hedging capital markets risks for GMDBs are less critical than for living benefit riders.

We are concerned that, under a fair value model, best estimate insurance related assumptions require additional risk margins (somewhat akin to Provisions for Adverse Deviations/PADs) as opposed to an insurance model which is based on best estimates without PADs. This anomaly would create non-economic reductions to retained earnings upon transition.

We would also note that currently the accounting for GMDBs across the industry is generally applied consistently and well understood by users.

**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 other comprehensive income? If not, what other alternative or alternatives do you recommend and why?

**Answer:** Yes, with the exception of GMDBs as described above in Question 13. We appreciate the FASB’s recommendations to eliminate the diversity in practice related to the accounting for certain living benefit riders on variable annuity products. We think that the consistency in valuation models or basis for benefit options and guarantees embedded in variable contracts of common risk characteristics should be improved and the economics of the market risks inherent in these variable products should be better reflected. Different interpretations of the embedded derivative accounting guidance for valuing certain liabilities of variable products could have, to some extent, resulted in various valuation models resulting from nuances in product design rather than from underlying economics. Currently, we value the liability of our variable annuities products with GMAB, GMWB, and GMIWB/GMWBL in accordance with FAS
133 and FAS 157 for GAAP reporting, which we would propose to retain under the proposed amendments on the accounting for Market Risk benefits. The fair value changes attributable to a change in the instrument-specific credit risk are currently recorded entirely in net income.

We are supportive of recognizing the fair value changes attributable to a change in the instrument-specific credit risk (Nonperformance Risk) in other comprehensive income. We also agree that the separation of the liability measurement of the Nonperformance Risk from the market risks as described in the proposed amendments would improve consistency in the fair value measurement of Market Risk Benefits across industry.

**Deferred Acquisition Costs Amortization**

**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?

Answer: No. While in theory, expanding the scope to include investment contracts would provide for consistency amongst products sold by insurance entities, we don’t believe expanding the scope warrants the additional operational efforts involved. Deferred acquisition costs (DAC) that are amortized using the interest method generally represent a very small percentage of a total companies’ DAC balance.

A potential improvement, for consideration, might be to leverage the previous work the FASB did in simplifying the presentation of Debt Issuance Costs (ASU 2015-03) and extend that concept to DAC amortized using the interest method, i.e., the DAC would be a reduction to the carrying amount of the investment contract liability. This would technically result in a consistent amortization standard related to deferred acquisition costs classified as assets, i.e. for contracts not amortizing using the interest method. For disclosure purposes, the amount of DAC capitalized during the reporting period (for DAC scoped in under the interest method) could be reflected as a separate line item in the liability roll forwards.

**Question 16—Amortization:** Do you agree with the proposed amendments that would simplify the amortization of deferred acquisition costs? If not, what other simplified and reasonably estimable amortization approach or approaches do you recommend and why?

Answer: Yes. In general, we are very supportive of the proposed amendments that would simplify the amortization of DAC. We agree that these changes reduce complexity and improve clarity of financial statement results, especially as it pertains to the elimination of estimated gross profits (EGPs) as a basis for amortizing DAC. We hope that there will be some additional guidance provided or some flexibility in applying the straight line method, to better reflect the impacts of certain items such as partial surrenders on the amortization pattern. For example, amortization related to variable annuities might be based on net deposits.

**Question 17—Impairment:** Do you agree that deferred acquisition costs should not be subject to impairment testing? If not, what alternative or alternatives do you recommend and why?

Answer: We are somewhat concerned with the elimination of impairment testing for DAC. We refer you to the Executive Summary of Comment Letter No. 1 titled “Life Insurer Comments on Field Testing of
the FASB Proposed Accounting Standards Update on Targeted Improvements to the Accounting for Long-Duration Contracts”.

**Presentation and Disclosure**

**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?

**Answer:** While we generally agree that certain additional disclosures are necessary and useful, we are concerned that the volume of the disclosures, as proposed, may be overwhelming and cause the useful information included in the disclosures to be obscured. For example, while we believe that liability rollforwards within an operating segment can provide useful information to users at the appropriate level of aggregation, the new requirements would result in significant additional and detailed disclosure which may be overwhelming, create user confusion and result in misinterpretation. Our particular concerns relate to:

- **Significant inputs, judgements, and assumptions:** Quantitative disclosures of ranges and/or weighted averages related to insurance assumptions would not be meaningful and the level of disaggregation that would be needed in order for the ranges to be useful would be unmanageable. Additionally, disclosure of significant inputs and assumptions, particularly as it relates to earned rates and credited rates, may lead to disclosure of proprietary information.
- **Rollforwards:** We are concerned with the prescriptive and detailed nature of the required rollforwards for future policy benefits and policyholder account balances. Relevant categories or components of a rollforward would be different depending on the type of business or product.
- **Frequency:** Because of the proposed simplified accounting for DAC, interim rollforward disclosures do not seem necessary at a segment level.
- **Operational cost and complexity:** It would be costly to effectively provide this info at the level and frequency proposed. We would need to build new processes and exhibits to extract this additional detail which would require either a sizeable technology build or an increase of head count. Once the large upfront cost was complete there would be ongoing maintenance. There would also be a significant add to the level of control to ensure that all updates were correct and complete.

**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.

**Answer:** Yes, we recommend that disclosures pertaining to loss recognition margins (based on the current GAAP definition for loss recognition testing) would provide users with valuable insight into the economics of insurance contracts.

**Effective Date and Transition**

**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?

Answer: To adopt the targeted improvements, we expect a minimum of four years is necessary to change, develop, and integrate our operating models and strategic management framework. A key dependency to implementing the standard will be the development and testing by third party providers of the actuarial software necessary to support the required reporting. Our expectation is that software vendors will require approximately 2 years to deliver upgraded products once the standard becomes final. Additional time will then be required by preparers to (1) purchase and/or implement the necessary systems and effect the process changes necessary to implement the standard; (2) run parallel processes under the existing standard and test the efficiency and effectiveness of the new control environment, (3) educate management, staff and the investing community, and (4) develop the necessary management reports to align with the new standard. Collectively to address these items, we believe a minimum of four years is necessary. However, the targeted improvements as modified by our recommendations, e.g. more practical expedients, could be implemented in less time but still would require a minimum of three years.

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?

Answer: Below are the transition concerns for the proposed targeted improvements.

Retrospective or prospective unlocking:
- **Retrospective**: As the FASB recognizes, companies may need to take different approaches at transition due to lack of experience data. This could exacerbate the problem of comparability of unlocking results. Companies which “pivot” from the transition date on certain blocks will have different results for the same degree of experience or assumption update compared to companies which fully or partially incorporate historical information. These differences will persist well into the future as in force slowly runs off.
- **Prospective**: Transition is no more difficult than implementing the method. It is also compatible with the pivot method used for DAC.

Market Risk Benefits:
The transition provision stated, “An insurance entity would measure market risk benefits at fair value at the beginning of the earliest period presented. The cumulative effect of changes in the instrument-specific credit risk between contract inception date and transition date would be recognized in the opening balance of accumulated other comprehensive income. The difference between fair value and carrying value at the transition date, excluding the effect of changes in the instrument-specific credit risk, would require an adjustment to the opening balance of retained earnings.”

Under a full retrospective approach, we are concerned with the level of difficulty associated with implementation that can be caused by the necessary granularity (rider level, product level, by issue year or issue month, etc.) and/or availability of historical data that might be required for calculating the opening balances of the AOCI. We would recommend that the final standard provide certain practical expedients
or simplified approaches for ease of operation. For example, we think that measuring the attributed fee for in-force contracts at transition is generally not possible without the use of hindsight.

We also recommend the final standard clarify the definition of the cumulative effect of instrument specific credit risk when converting a variable product that would be newly required to be fair valued in accordance with the proposed Market Risk Benefits measurement at the transition date.

We are also concerned by the level of difficulty and complexity that multiple valuation system conversions since inception can cause for implementation.

**Deferred acquisition costs amortization:**
In general, we are very supportive of the transition provision for DAC. Since DAC is now considered a non-monetary asset, i.e., not subject to foreign exchange remeasurement, we would recommend that the final standard acknowledge that the DAC balances would not be adjusted at transition. In addition, it should be noted that DAC amortization, under the EGP method, have historically reflected the impact of changes in a company’s own credit risk in net income, i.e., market risk benefits accounted for as embedded derivatives. Given that, under the proposed guidance, changes in a company’s own credit risk related to market risk benefits would be reflected in AOCI at transition, we recommend that the balances for DAC at transition be adjusted for the exclusion of the impacts of a company’s own credit risk on DAC balances. The recommended adjustment would be included in the disclosures at transition.

**Question 22—Transition disclosure:** Do the proposed transition disclosure requirements provide decision-useful information? If not, what would you recommend and why?

**Answer:** Our recommendation for using a prospective rather than retrospective approach would alleviate our concerns with transition disclosure.

**Costs and Complexities**
**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.

**Answer:** The incremental costs of adopting the proposed amendments, particularly as it relates to the retrospective method, would result from the need for a sizeable technology build, changes to actuarial systems, and/or increased head count, and need to build new processes and exhibits to extract the detail and to frequently be updating all the disclosure items. Once the large upfront cost is complete, there would also be ongoing maintenance expenses.

Below is the detail for the complexities estimation for one of the existing actuarial valuation systems on FAS 60/97LP unlocking.

**Retrospective:** In general, preparing for the retrospective method would entail the most work in terms of both coding and data management.
- To reflect actual historical experience, cohort processing would have to be created, analogous to DAC calculation.
• Source of Earnings would be difficult to organize.
• Robust historical records would need to be set up.
• Judgement would be involved in defining the cohorts.

Prospective: The system logic is available as the actuarial valuation system uses the prospective method in certain situation (e.g. PGAAP). Auditability of reserve would require some thought, as calculations might have to trace through several pivots. Source of Earnings would be fine, but only from pivot data. It would be complicated to make it work for periods prior to the pivot.

The implementation effort will entail significant changes to systems, process and controls. The proposal will affect the entire organization and will require all stakeholders (i.e. actuarial, controller, risk management, product development, IT, etc.) to be involved from planning to implementation.
Attachment 1

To illustrate the benefit of our recommendations on the discount rates, below is an example of how earnings would emerge for a structured settlement product with and without life contingencies under these different approaches.

Under the current accounting, Structured Settlements with and without life contingencies have a consistent earnings pattern while following FAS 97LP and FAS 91 accounting respectively. Under the proposed accounting, the with life contingencies would have a substantial day 1 loss followed by higher earnings in all future periods. If instead A yield is used, this impact is partially dampened. If the representative portfolio is used instead, then the accounting will align with the without life contingencies version of the product. By using a representative portfolio, FASB will improve on consistency and transparency while mitigating the unintended consequence of day 1 losses for limited pay business.

*This would also be consistent with the pricing spread option described on page 4.*