December 15, 2016

Ms. Susan Cosper, Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
director@fasp.org

Re: Exposure Draft
    Proposed Accounting Standards Update
    Financial Services–Insurance (Topic 944)
    Targeted Improvements to the Accounting for Long-Duration Contracts

Dear Ms. Cosper:

Protective Life Corporation (the “Company” or “Protective”) appreciates the opportunity to comment on the FASB’s Exposure Draft – Targeted Improvements to the Accounting for Long-Duration Contracts (the “Exposure Draft”). Protective operates a group of insurance companies in the United States that provides financial services primarily through the production, distribution, and administration of insurance and investment products.

The stated main objective of these proposed amendments is to make targeted improvements to the existing recognition, measurement, presentation, and disclosure requirements for long-duration contracts issued by an insurance entity. As requested by the Board, we have provided our comments organized as responses to the questions presented in the Exposure Draft. As noted in our responses, we believe there are aspects of the Exposure Draft which achieve the Board’s stated objective. However, as you will also note, there are a number of areas where we respectively disagree with the Board’s proposed amendments. Those areas of disagreement are noted along with our suggested alternatives in our answers to the questions below.
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 1 — Yes, we agree with the FASB’s proposal to periodically unlock the cash flow assumptions used in the estimation of the liability for future policy benefits of Traditional and Limited-Payment contracts. However, if the FASB agrees that the effect of updating cash flow assumptions should be calculated and recognized on a prospective basis (see our response to Question 2), then that approach should also be extended to SOP 03-1 reserves on non-Traditional products covering benefits described in paragraphs 944-40-25-26 through 25-27A. Not doing so would create an inconsistency between the liability model for those benefits on non-Traditional products and the FASB’s proposed approach for reserving for the policy benefits of Traditional Life and Participating contracts. A prospective method would also be more consistent with the FASB’s proposal to perform the profits followed by losses test annually when assumptions are updated because it would avoid an inappropriate sudden increase in the SOP liability upon failing the test after having previously passed it.

The non-Traditional reserve model should further be aligned with the Traditional Life and Participating models by requiring an effective yield method for discounting liability cash flows whereby the discount rate would be set to maintain a constant spread over the projected credited rates. In cases where the liability cash flows are dependent on the portfolio of assets backing the liabilities, the effective yield should be reset prospectively when a change in the assumed portfolio yield would lead to a change in the expected payments to policyholders. Finally, instead of the SOP 03-1 reserve on non-Traditional products being the sole balance sheet item still requiring a shadow adjustment, the same OCI approach as that proposed for Traditional and Participating products should be applied to the SOP 03-1 reserve on non-Traditional products.

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 2 — No, we do not support updating cash flow assumptions on a retrospective basis and feel that a prospective approach to assumption unlocking is more appropriate for the following reasons:

- Retrospective unlocking is inconsistent with the approach taken by the IASB under IFRS which is more consistent with a prospective approach to assumption unlocking.
Applying a significantly different approach compared to the IASB has the potential to create confusion for U.S. subsidiaries of a foreign parent that reports under IFRS.

- The properties of a prospective approach to unlocking assumptions are preferable to a retrospective approach because the timing of assumption changes and experience adjustments are more closely aligned with the periods over which the impacts are recognized.

The Board states that it supports a retrospective approach because it allows for future profits to emerge on the basis of new assumptions without being encumbered by prior periods. In fact, under retrospective unlocking, the impact of historical events is partially spread over future reporting periods, and the impact of changes in future estimates is attributed to current period earnings. Retrospective unlocking “encumbers” future earnings by deferring the recognition of part of the impact of an experience adjustment. It is then necessary to attribute the impact of a future assumption change to the current period in order to reverse prior amounts that arguably should never have been deferred.

- Retrospective unlocking produces results that are unintuitive and unnecessarily complicated to the users and producers of financial statements. The producers of the financial statements spend a considerable amount of time analyzing, explaining, and justifying retrospective unlocking. In order for stakeholders to focus on the nature of the business, they must first untangle the web of retrospective unlocking that hangs over the results.

- The premise upon which retrospective unlocking is based – that the calculations should be done using assumptions and experience as if they had been known at issue – is contrary to fact and leads directly to the undesirable result that assumption changes and experience adjustments are misaligned with the periods over which the impacts are recognized. Experience adjustments that are due to the volatility of the underlying insured risk are unpredictable by definition and should be accounted for as such. Similarly, retrospective unlocking accounts for changes in future assumptions that are due to an unforeseeable change in circumstances (for example, a new medical procedure that reduces mortality) as if it should have been anticipated. To base the reserving model on the notion that experience variations are predictable and the future state of the world is known in advance results in misleading information being presented to stakeholders.

- The “mechanics” of retrospective unlocking give the concept an air of mathematical precision that is undeserved. It is actually a bad idea posing as a principled approach to accounting.

- Retrospective unlocking of reserves is inconsistent with the goal of simplifying GAAP accounting. The Board recognized the problems associated with retrospective unlocking of DAC and responded accordingly by simplifying the DAC amortization model.
Overcomplicating the traditional life approach to reserving will offset the benefits of simplifying the DAC model.

- Perhaps the worst aspect of retrospective unlocking is the considerable effort and cost that are necessary to support it. Retrospective unlocking requires an entity to accumulate and maintain historical cash flows from the inception which necessitates a substantial amount of effort throughout an organization both to implement the new regime and to maintain it going forward. While some organizations have already developed the necessary capabilities to support retrospective unlocking on their annuity and universal life blocks, their traditional life blocks are often significantly larger and older, so the effort will still be substantial. Prospective unlocking is much simpler and less costly to perform because it does not require that historical cash flows be maintained.

- In summary, retrospective unlocking is inconsistent with IFRS, runs contrary to basic accounting principles, is unintuitive, is overly complicated, is based on a false premise, provides a false sense of precision, and is costly to implement and maintain. Extending it to traditional life and participating products would be an unfortunate mistake. See the Appendix at the end of this letter for an example demonstrating the differences between retrospective and prospective unlocking.

We instead support a prospective approach to assumption unlocking as well as an approach whereby experience variances are recognized in earnings as they occur along with an appropriate reserve offset. Under this approach the net premium ratio would be calculated as of the prior quarter end as the carrying amount less the present value of future expected benefits divided by the present value of future expected gross premiums, where expected amounts reflect assumption updates if applicable. The change in reserve would reflect terminations as it does today for Traditional Life contracts, but it would not include the entire experience variance adjusted for retrospective unlocking as is the case under the FASB’s proposal.

There are several advantages to this approach:

- It accomplishes the FASB’s goal of unlocking assumptions on Traditional Life contracts while maintaining the significant characteristics of the Traditional Life model that users are familiar with. In particular, the concept of GAAP mortality variance (expected versus actual deaths on net amount of risk) continues to be a meaningful concept under the approach described above, whereas under the proposed approach in the ED, GAAP mortality variance is zero by definition at issue, increasing to 100% of the claim variance at the end of a cohort’s life.

- If preferred, reserves could continue to be computed on a seriatim basis since under a prospective approach to unlocking, it is not necessary to organize contracts into cohorts as it is under a retrospective approach. On the other hand, it does not prevent
companies from grouping policies into cohorts to achieve model efficiency techniques. In the former case, the net premium ratio will be specific to a policy, whereas in the latter case, the net premium ratio will be an average over all of the policies in the cohort. The two approaches would not be expected to achieve meaningfully different results except to the extent that the likelihood of exceeding the 100% net premium ratio cap decreases as the level of aggregation increases.

- The cost and complexity of the transition would both be greatly reduced relative to a retrospective approach. It would not be necessary to recreate historical cash flows or, assuming a seriatim valuation was performed, organize policies into cohorts.

**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 3** — Yes, we agree with the proposed frequency and timing of cash flow assumption updates proposed in the ED. However, the final amendments should clarify that the requirement is for assumptions to be reviewed and, only if necessary, updated.

**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 4** — No. A high-quality fixed-income instrument yield, as proposed and interpreted under existing GAAP, is not an appropriate discount rate to use for calculating the long duration liabilities held by life insurance companies because it does not reflect the nature of the illiquidity premium associated with those liabilities and the effect that illiquidity premium should have on the discount rate over the credit cycle. We understand that a high-quality fixed-income instrument yield is currently interpreted to equate to an AA rated fixed-income financial instrument. The yield of a single A rated fixed-income instrument would better reflect the liquidity characteristics of the liabilities of the life insurance industry as a whole.

**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 5** — Yes, we agree with the proposal and believe that it will reduce the accounting mismatch that currently exists on the balance sheet between liabilities and the assets backing those liabilities that are classified as available for sale.
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 6 — Yes, again we believe that this will more closely align the accounting treatment of the liability side of the balance sheet with the asset side, thereby eliminating accounting mismatches. However, the FASB should clarify that this requirement does not mandate that cohorts contain only one calendar quarter of new issues, which would result in an unmanageable number of cohorts, and that approaches that calculate an average discount rate over a range of issue dates are acceptable.

Liability for Future Policy Benefits—Participating 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 7 — It depends. We agree that participating contracts should be included in the scope of the proposed amendments if the problems identified in the response to Question 10 are addressed. If the FASB is unable to address the problems with the discount rates, then participating contracts should be excluded from the scope of the proposed amendments.

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 8 — No. See our answer to Question 2 which is also applicable to Question 8.

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 9 — Yes, however, given the dynamic relationship between projected yields and credited rates, if discount rates are updated quarterly, updates to projected yields and credited rates should occur at the same frequency.
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 10 — No. The discount rate assumption for participating products should reflect the dependency of the liability cash flows on the underlying assets to avoid the illogical results that would otherwise emerge if spreads on the underlying assets and the high-quality fixed-income instrument yield fail to move in tandem. An effective yield approach, as more fully described in our response to Question 1 and as originally proposed by the FASB under the joint Insurance Contracts project with the IASB, would be appropriate for Participating contracts. In addition, our response to Question 4 is even more relevant to Participating contracts, where the investment experience is passed through to the policyholder, than it is to Traditional Life contracts.

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 11 — Yes, for the reason stated in the response to Question 5. However, our statement in the response to Question 9 is applicable to Question 11 as well.

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 12 — Yes, for the reason stated in the response to Question 6. However, the statements in the responses to Questions 6 and 9 are applicable to Question 12 as well.

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 13 — No. The diversity of practice surrounding market risk benefits (as an embedded derivative valued at fair value, a survival component valued under SOP 03-1, or both) is associated mainly with Guaranteed Living Withdrawal Benefits (“GLWB’s”). Rather than making sweeping changes to existing practice, the FASB could provide additional guidance to clarify that market risk benefits with elective features should be accounted for as embedded derivatives. The scope of the guidance should exclude non-elective market risk benefits such as
Guaranteed Minimum Death Benefits ("GMDB’s"). Since it is less likely that GMDB’s would be hedged, the proposal to fair value GMDB liabilities would create an accounting mismatch which would lead to undue volatility in net income.

Alternatively, the FASB could allow insurance entities to make an entity-wide accounting policy election to measure and recognize at fair value market risk benefits, as defined by the FASB, for each type of benefit.

**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 14 — In part. We agree that the fair value changes attributable to a change in the instrument-specific credit risk be recognized in other comprehensive income for those market risk benefits valued at fair value. However, as described in our response to Question 13, we do not agree with the scope of the proposal to value all market risk benefits at fair value.

**Deferred Acquisition Costs**

**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 15 — Yes, we believe that there should be an option to apply the simplified DAC amortization model to investment contract acquisition costs.

**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 16 — Yes, we agree with the FASB’s proposal to simplify the amortization of deferred acquisition costs and feel that it will both reduce the cost of preparing financial statements and increase the usefulness of those statements to users.

**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 17 — Yes. We agree with the Board’s analogizing the accounting treatment of DAC with debt issuance costs that are not subject to impairment testing. Attempting to apply impairment testing within the proposed simplified DAC amortization framework has the potential to eliminate many of the benefits derived from the model simplifications. One of the primary advantages of the proposed framework is that it eliminates the need to estimate future
EGP’s and EGM’s. Any impairment test would likely require a comparison to future profitability. Devising a workable impairment test appears to be an endeavor that is incompatible with the elimination of accrued interest from the DAC model.

Finally, while the simplified DAC model is applicable to all life products, the FASB’s targeted approach to updating the liability models for policyholder benefits means that different product types employ different approaches to calculating the liability. Those differences in the liability calculations would necessitate differences in the impairment tests applicable to the different product types. Requiring different impairment tests for different blocks of business could potentially: create a more burdensome DAC impairment test than exists today, create confusion as to the applicable test for a given block of business, and lead to unintended differences in the amount of DAC that is impaired across different blocks of business.

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 18** — No, we disagree. While certain additional disclosures are necessary, we are concerned the volume of disclosures proposed is too great and could be confusing to financial statement users. We feel that the FASB should allow a company to exercise judgment in determining which disclosures would provide meaningful information to users. Disclosures that may fail to provide meaningful information, for example, the quantitative information requirement (i.e., the range, weighted averages, and actual) for certain assumptions, such as mortality and lapse, should not be required.

**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 19** — No, we do not feel that any additional presentation or disclosure requirements are necessary.

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 20 — The key drivers affecting the timing of implementation are listed below in descending order from the most to least significant:

- Modifications to valuation system
- Modifications to financial reporting processes
- Gathering the historical data necessary to restate the Liability for Future Policy Benefits under the new method for traditional life and participating contracts
- Defining cohorts for traditional life and participating contracts
- Training / Educating users and producers of financial information
- Quantifying the impact to retained earnings and analyzing the impact on the emergence of future earnings

**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 21 — Yes. However, further guidance is needed to clarify the implementation guidance as it relates to previously acquired blocks of business as of the transition date. In the sentence “The entity should then recalculate the net premiums as of the issue date of the contract by considering actual historical cash flows and the updated expected future cash flows, discounted using a rate based on a high-quality fixed-income instrument yield” from paragraph 944-40-55-131.a., we interpret issue date to be the acquisition date if the policy issue date precedes the acquisition date and that the existing carrying amount as of the acquisition date less the present value of future benefits should be compared with the present value of future gross premiums to calculate the net premium ratio.

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

Answer 22 — Yes, the transition disclosures related to accounting changes, the portion of the liability not subject to retrospective application, and qualitative and quantitative information about transition adjustments provide decision-useful information.

**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 23 — The one-time costs are those costs associated with the list of items in the answer to Question 20 above. Our thoughts related to incremental ongoing costs are as follows:
• The simplified DAC model would reduce ongoing costs; however, those savings would likely be offset by new DAC impairment requirements if they are introduced in a future revision to the exposure draft (see Answer to Question 17).

• Significant ongoing costs would be likely under the proposal to require retrospective unlocking of the Liability for Future Policy Benefits on traditional and participating contracts. As described in the answer to Question 2, retrospective unlocking on blocks of business that currently have locked in assumptions will require significant ongoing incremental costs both to accumulate and maintain the historical data required to perform retrospective unlocking as well as to understand the effects of unlocking and to communicate that understanding to stakeholders. If the costs that would be required to support retrospective unlocking were in support of changes that were an improvement over the current reserving model, they could be justified, but retrospective unlocking will offset any other benefits of the proposed changes to the reserving model on traditional and participating contracts. In additional to being more theoretically sound than retrospective unlocking, prospective unlocking would eliminate much of the incremental cost of the current proposals related to the Liability for Future Policy Benefits on traditional and participating contracts.

• If the proposals related to Market Risk Benefits are implemented for all GMXB’s, the ongoing incremental cost would be significant. While in some cases it would be possible to borrow from existing processes for valuing embedded derivatives on variable annuities, doing so on GMDB’s on Variable Universal Life (“VUL”) would not be possible since we currently have no benefits on that product that are fair valued.

• The numerous new disclosures will increase the ongoing costs. This is less of an issue where the benefits of the disclosures exceed the costs. However, disclosures that fail to provide meaningful information, for example, the quantitative information requirement (i.e., the range, weighted averages, and actual) for certain assumptions, such as mortality and lapse, should be eliminated.

We understand and appreciate the enormity of this project and would like to participate in any future roundtable discussions on these proposed amendments. If you have any questions regarding this letter or wish to discuss further, please contact me at (205) 268-6775 or Charles Evers, Vice President, Corporate Accounting (responsible for accounting policy matters) at (205) 268-3596.

Sincerely,

Steven G. Walker
Executive Vice President, Chief Financial Officer
and Controller
Appendix: Retrospective versus Prospective Unlocking
(Related to our answer to Question 2)

The following example illustrates the differences between retrospective and prospective unlocking of the Net Premium Ratio. The simple example is based on a hypothetical block of 10-year term policies. For simplicity, expenses are assumed to be zero, annual premiums are paid at the beginning of the year, policyholder benefits are paid mid-year, the yield curve used for discounting premiums and benefits is a level 4.5%, and financial reporting is performed only once per year at the end of the year.

In Table 1, it is assumed that benefits emerge over time as originally expected at issue. As such there is no unlocking (prospective or retrospective) of the net premium ratio, which remains at 80.3% for all years, and profits emerge as a level percentage equal to 19.7% of the gross premiums.

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*Benefits Emerge as Expected

Table 2 demonstrates the effects of retrospectively unlocking the net premium ratio assuming that policyholder benefits emerge 10% higher than originally anticipated. For the first three years, assumptions related to policyholder benefits remain unchanged from the assumptions set at issue. At the beginning of year 4, as a result of the prior three years of higher than expected benefits, policyholder assumptions are updated to reflect the expectation that benefits will also be 10% higher than originally assumed going forward.

In the first year, the higher than expected benefits of $2.50 are entirely offset against the reserve thereby masking the poor experience. While the net premium ratio increases slightly, the majority of the experience variance is effectively deferring to future periods. Since no history has been accumulated as of the first year, there is no unlocking of the reserve. In the
2nd year, the experience variance leads to some reserve unlocking; however, most of the impact from the experience being worse than expected is again deferred. In the 3rd year, unlocking offsets a larger proportion of the experience variance, but the majority of the variance is still deferred.

If the future assumptions were never updated, the unlocking would continue to grow as a percentage of the experience variance until it equaled 100% of the variance in year 10. Instead, in the 4th year the assumptions as to future policyholder benefits are updated, and there is a large unlocking of the reserve of $21.14 which causes income for the year to be negative. About 1/4th of the unlocking is to reverse the losses that had been deferred into the future over the prior three years. The remainder of the unlocking effectively shifts prior profits into the future.

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NPV $613.68 $541.75 0.883 $71.93

*Benefits Emerge 10% Higher than Expected and Assumptions are Updated at the Beginning of Year 4

Table 3 demonstrates the effects of prospectively unlocking the net premium ratio assuming that policyholder benefits emerge 10% higher than originally anticipated. Over the first 3 years, the worse than expected mortality impacts earnings as it is experienced. In the 4th year, when the assumptions are updated, the net premium ratio is prospectively unlocked. In years 5 and later, earnings are about 2/3 of the amount under retrospective unlocking.
While retrospective unlocking has the benefit of “signaling” financial statement users that assumptions have been updated after the fact, it also has the disadvantage of giving no indication that experience has been worse than anticipated leading up to the change because the experience variances are offset against the reserve. Thus, there is no forewarning of the unlocking event to come. Furthermore, if changes in the net premium ratio are disclosed under the prospective approach to unlocking, then this advantage of retrospective unlocking largely disappears.

Both prospective and retrospective unlocking are approaches for allocating profits, and it is not possible to say that one such approach is more theoretically correct than another. In the end any two approaches have to be judged against each other based on the relative costs required to support them and the preferable properties that one approach has over another. In both cases, prospective unlocking wins out over retrospective unlocking.