



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

Re: *File Reference No. 2015-220 –
Exposure Draft, Derivatives and Hedging (Topic 815): Disclosures about Hybrid Financial Instruments
with Bifurcated Embedded Derivatives*

Dear Ms. Coper:

The American Council of Life Insurers (ACLI)¹ appreciates the opportunity to comment on the FASB's Exposure Draft, *Derivatives and Hedging (Topic 815): Disclosures about Hybrid Financial Instruments with Bifurcated Embedded Derivatives* (the "Exposure Draft"). Our letter will focus on the impact of the Exposure Draft on Insurance Contracts that contain bifurcated embedded derivatives, while also providing comments on financial assets that contain these features. We do not believe the Exposure Draft will provide more transparent, decision useful information about Insurance contracts with bifurcated embedded derivatives, and may actually make it more difficult for financial statement users to understand the overall risks and economics of Insurance contracts.

Comments with Respect to Insurance Liabilities

We do not believe contracts accounted for in part or in their entirety under ASC 944, *Financial Services – Insurance* ("ASC 944, Topic 944") should be included in the scope of the exposure draft. The proposed disclosure originated from the Financial Instruments project that scoped out insurance contracts and we believe this Exposure Draft should also exclude contracts accounted for in part or in their entirety under Topic 944. Contracts accounted for under ASC 944 that contain bifurcated embedded derivatives include variable annuity contracts with guaranteed minimum benefits, certain

¹ The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. ACLI advocates in federal, state and international forums. Its members represent more than 90 percent of the assets and premiums of the U.S. life insurance and annuity industry. In addition to life insurance, annuities and other workplace and individual retirement plans, ACLI members offer long-term care and disability income insurance, and reinsurance. Its public website can be accessed at www.acli.com.

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reinsurance contracts, equity-indexed universal life contracts and equity-indexed fixed annuities. Although insurance companies bifurcate and recognize embedded derivatives for these relevant contracts in accordance with Topic 815, we are concerned that the proposed tabular reporting format for these insurance-related embedded derivatives would not increase transparency, nor provide useful information for financial statement readers.

With respect to variable annuities, certain guaranteed benefit riders are accounted for at fair value as bifurcated embedded derivatives, particularly guaranteed minimum withdrawal benefits riders. An insurer could account for a variable annuity contract with embedded derivatives in three separate line items on its balance sheet: (1) separate account liability reflecting the policyholder's variable account value, (2) a reserve for policyholder benefits reflecting any death benefits or other benefits not accounted for as embedded derivatives available under the contract, and (3) a policyholder funds liability for the policyholder's stable account value and the guarantees accounted for as embedded derivatives. It is not clear which components would constitute the "related host contract" per the example in proposed ASC 815-10-55-183A which may result in reporting misleading information to the readers of insurance company financial statements. Additionally, explaining the various measurement attributes in this context to satisfy a specific proposed embedded derivatives disclosure would also be confusing, especially since insurers' significant accounting policy disclosures generally explain, in an understandable manner, the accounting for the host insurance contract. Similarly, identifying the various income statement lines and amounts would be confusing.

Additionally, guarantees accounted for as embedded derivatives are often significantly inter-related with other guarantees accounted for under Topic 944 as an additional insurance benefit to the base contract. For example, variable annuities often contain a guaranteed minimum death benefit (GMDB) accounted for under Topic 944 as well as a GMWB that some companies account for as embedded derivatives. Similar issues can exist with equity-indexed fixed annuities that contain multiple guarantees accounted for under both Topic 944 and Topic 815. In these cases, the users of our financial statements must examine the base contract, additional insurance benefit and embedded derivative together to obtain the complete picture of an insurance contract. The Exposure Draft would instead focus on the host contract and embedded derivative, omitting crucial information about other guarantees accounted for under Topic 944.

Another source of confusion that would result from the proposed disclosure requirements concerns embedded derivatives associated with certain modified coinsurance contracts. For reinsurance contracts that include both coinsurance and modified coinsurance arrangements, we question whether the host contract is the entire reinsurance contract, or just the portion for which the invested assets were retained by the ceding insurer. In addition, for such host contracts, explaining the various measurement attributes to satisfy a specific proposed embedded derivatives disclosure would be confusing. The measurement attribute of a reinsurance contract would include the insurance and reinsurance accounting requirements of ASC 944, with presentation of items such as premiums, benefits, expense reimbursements, changes in amounts recoverable from reinsurers, and other items reflected in several places in the income statement. A reader gains a better understanding of such attributes through current accounting policy disclosures of insurance enterprises.

ACLI would like to note that, for insurers, only those insurance contracts with features accounted for as bifurcated embedded derivatives would be disclosed in the table. Additionally, the table focuses on host contracts and the related embedded derivatives, while omitting information on other guarantees measured, under Topic 944. As a result, insurers may feel the need to reconcile these proposed disclosures to their overall insurance contract portfolios to avoid any possibility that financial statement users overly rely on, or are potentially misled by, the figures in the table. This additional work, in our view results in costs of complying with the disclosures to well exceed any benefits they would provide.

Finally, any disclosure enhancements for contracts within the scope of ASC 944 should be further considered as part of the long-duration insurance contracts targeted improvements project. Absent a scope out of insurance, we would request additional clarification in applying the proposed disclosure requirements to insurance and reinsurance contracts. Additional guidance or examples specific to insurance contracts and what constitutes the “related host contract” would be helpful to preparers and users of financial statements.

Other Comments

The Exposure Draft’s example introduces the new, undefined term, “Statement of Financial Performance.” We do not know if this includes only the statement of income, or whether it is meant to also include other comprehensive income (OCI). With respect to available-for-sale debt securities, we question whether the proposed disclosure would include net investment income for interest, realized capital losses for impairment, and OCI for unrealized gains/losses.

In summary, we believe a scope-out or additional clarification is needed to appropriately apply the proposed disclosures to insurance contracts. We welcome your feedback and questions on our submission.

The following Appendix provides responses to the specific Exposure Draft questions for respondents.

Sincerely,

A handwritten signature in black ink, appearing to read "M Monahan". The signature is fluid and cursive, with a long horizontal stroke at the end.

Mike Monahan
Senior Director, Accounting Policy

APPENDIX QUESTIONS FOR RESPONDENTS

Question 1 – Will the amendments in this proposed Update result in more transparent, decision-useful information about hybrid financial instruments with bifurcated embedded derivatives? If not, please explain why.

ACLI Response:

No, we do not believe the proposed disclosures would result in more transparent decision-useful information for the reasons outlined in our letter. The primary instruments in scope for insurers would be variable annuity contracts, certain reinsurance contracts, equity-indexed life and annuity contracts, and equity-indexed universal life contracts. Given the complexity of these instruments and the ongoing targeted improvements project for insurance, we believe insurance contracts should be scoped out of the Exposure Draft. The disclosure requirement in the Exposure Draft emanated from the Financial Instruments project that scoped out insurance contracts and we believe this Exposure Draft should also exclude contracts accounted for in part or in their entirety under ASC 944.

Question 2 – Should the scope of the amendments in this proposed Update be extended to include nonfinancial hybrid instruments with embedded derivatives that require bifurcation under Topic 815? If yes, please explain why and identify any other instruments that should be included in the proposed amendments.

ACLI Response:

We do not support extending the scope of the Exposure Draft to include nonfinancial hybrid instruments without a further consideration of the types of instruments that would be included.

Question 3 – Are the proposed disclosure requirements operable and auditable? If not, which aspects pose operability or auditability issues and why?

ACLI Response:

As discussed in our letter above, we do not believe the proposed disclosure requirements are operational for insurance contracts with bifurcated embedded derivatives given the complexity of insurance contracts. The tabular format example in ASC 815-10-55-183A may function well for “plain vanilla” instruments such as a convertible bond, but it would not be operational for insurers to explain the multiple balance sheet line items impacted and their measurement attributes in the suggested format, as well as multiple income statement lines.

Question 4 – The proposed amendments would apply to all entities. Should the proposed amendments be different for entities that are not public business entities? If so, please describe how and why you think they should be different.

ACLI Response:

We do not believe the benefits of the proposed disclosures would be significant for most entities.

Question 5 – How much time would be needed to implement the proposed guidance? Should the amount of time needed to implement the proposed amendments by entities that are not public business entities be different from the amount of time needed by public business entities?

ACLI Response:

We do not believe the time needed to implement the proposed disclosures is overly prohibitive for public or private entities. As discussed above, we do not believe the proposed disclosures provide significant benefits to users, nor are disclosures of insurance contracts in the suggested tabular format operational.