



December 12, 2016

Technical Director
File Reference No. 2016-330
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

The Statutory Accounting Principles (E) Working Group (SAPWG) of the NAIC¹ is responsible for the development and enhancement of Statements of Statutory Accounting Principles (SSAPs) used by U.S. insurers in their statutory filings. Statutory Accounting Principles (SAP) presents an effective, comprehensive and understood approach, which has been built using the framework established by U.S. GAAP. Under the SAP process, all new GAAP issuances are considered and ultimately adopted, adopted with modification, or rejected. Although SAP may make some modifications, it is preferred to have minimal differences in accounting methodologies between SAP and GAAP, with as limited variations as possible to meet regulatory objectives. Consequently, proposals that significantly revise GAAP standards are a vital matter for U.S. regulators.

The statements within this letter are predominantly from the viewpoint of the financial statement user. The NAIC's primary goal is to protect policyholders, including regulation of insurer financial solvency, with direct interest in minimizing differences between GAAP and SAP, however, our responsibilities are not limited to this role. We have a profound interest in ensuring insurers have access to capital markets to obtain capital to expand their business, to provide new and innovative products, to increase competition in existing markets as well as to meet liquidity and capital needs in possible stress situations, all of which are benefits for policyholders. As such, we have a keen interest of revisions proposed to general purpose financial statement accounting standards.

The SAPWG has historically followed the development of U.S. GAAP insurance revisions, and supported the separation of the insurance project into short-duration and long-duration projects. The SAPWG also supported the approach to consider targeted revisions to existing requirements, and agrees that the targeted improvement approach will most likely result in meaningful improvements for financial reporting, without the extent of costs expected from incorporating new measurement models. Although considered targeted improvements, the SAPWG highlights that the proposed revisions in the ASU are significant changes from existing U.S. GAAP standards. We caution against assumptions that "targeted" is synonymous with "minimal" and encourage the FASB to take efforts to ensure an adequate timeframe for implementation, as well as, to consider industry and preparer concerns pertaining to application, transition and potential refinements to the standard during the implementation timeframe. We hope you find our input within this letter valuable.

Summary Position

U.S. regulators support the proposed ASU for long-duration insurance contracts as the guidance will improve decision-useful information necessary for financial statement users. As regulators use U.S. GAAP financial statements to evaluate the consolidated positions of insurance company groups, the proposed revisions are also

¹ The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC staff supports these efforts and represents the collective views of state regulators domestically and internationally. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

anticipated to positively impact regulators' ability to assess insurance companies using a comprehensive, consolidated approach.

Cash Flow Assumptions (*Questions 2-3, and Questions 8-6 for Participating Contracts*)

Consistent with previous comments, U.S. regulators agree that assumptions of risks and uncertainties should be "unlocked" - with periodic reevaluations and updates - to reflect available information. We agree that recognizing changes in assumptions, to reflect actual historical experience and updated future cash flows expectations, will provide more decision useful information to users on management's expectations of future net benefits to be paid.

U.S. regulators support the proposed guidance to update cash flow assumptions on an annual basis, at the same time every year, or more frequently if actual experience or other evidence indicates that prior assumptions should be revised in the interim. Although our prior comments previously supported updates "each reporting period," we agree that annual updates are sufficient in providing timely information unless actual experience or other evidence suggests that earlier cash flow assumptions should be revised.

As U.S. regulators are focused on the use and relevance of the information presented in the financial statements, we are not commenting on the retrospective application process to update assumptions. We believe that comments on the ability to implement this process would be best addressed by the insurance company preparers. However, we do support the separate recognition processes for changes in cash flow and experience assumptions and changes from updating the discount rate. We agree that information on these components will allow for users to better understand the information presented in the financial statements and the effect of the specific changes. Lastly, we agree that the timely recognition of losses is a critical component for proper presentation by insurance companies; therefore when it is identified that expected benefits and expenses exceed expected gross premiums, we support the immediate full recognition of those expected losses, eliminating the ability to defer losses into future periods.

Discount Rates (*Questions 4-6, and Questions 10-12 for Participating Contracts*)

Consistent with previous comments, U.S. regulators continue to agree that the discount rate, when used, should reflect the characteristics of the insurance contract liability (i.e., the economics of the insurance obligations including the nature, structure and term). Also consistent with prior comments, U.S. regulators support consistent application, across different reporting entities, in calculating discount rates. We have previously noted concern on the use of different methods as that could potentially distort financial results and hinder the ease in which financial results can be compared. In accordance with our position, we support the approach detailed in the exposure draft in which entities would maximize current observable market prices of high-quality, fixed-income instruments with durations similar to the liability for future policy benefits in determining the discount rate. Comparable to our opposition on the consideration of own-creditworthiness in establishing the fair value of liabilities, we agree that similar contract liabilities across different reporting entities, which are not directly impacted by specific investment performance, should be determined similarly, and should not be impacted by the operational decisions (e.g., quality of the investment portfolio) of the separate reporting entities.

We understand the Board's simplicity rationale with the proposal to use the same discount rate approach for traditional, limited-pay and participating contracts, however, for discretionary components of participating components specifically attributable to investment performance, this approach could result with an inappropriate reflection of insurance contract obligations. As users of the financial statements, we must note that this approach could result with the financial statements not reflecting the most current view of an insurance company's expected future cash flows. However, before deviating from the simplistic approach, we would encourage consideration of comments from preparers on the application of the proposed discount rate approach, as well as an impact assessment to contract liabilities.

U.S. regulators identify that the timeframe to update the assumptions and the discount rate are proposed to be different in the exposure draft. (Cash flow assumptions would be updated at least annually, unless interim updates were warranted, and discount rates would be updated each reporting date.) We do not necessarily oppose this

guidance, but question whether the discount rate change for a high-quality, fixed-income instrument would vary enough between reporting periods to warrant the costs to conduct these calculations and incorporate the changes in the financial statements. Although we agree that an updated discount rate would provide a more current measurement at each reporting date, we share the prior user concerns about unnecessary capital volatility between reporting periods, as well as concerns that the cost and process changes required to incorporate this change would be excessive for the limited measurement clarity this change may provide. We would encourage the Board to consider comments received from the preparers of financial statements, particularly with regards to cost and implementation efforts needed to incorporate this proposal in comparison to the added measurement value, and potentially reassess whether discount rate changes could be considered on an annual basis. If reconsidered, we would suggest discount rate changes to occur simultaneously, and/or, based on the same thresholds as changes in cash flow assumptions. Under our recommendation, the discount rate would be updated annually, unless evidence exists indicating that the discount rate should be updated for an interim reporting date, or at any time in which cash flow assumptions are revised.

Market Risk Benefits (Questions 13-14)

Consistent with previous comments, U.S. regulators agree that insurance entity obligations representing policyholder funds, as the contract holder bears the investment risk, and the insurance entity's obligations under these contracts protecting against adverse capital market performance, should be reported at fair value through net income. We agree that the criteria established for these contracts and the insurance benefits are appropriate:

Contracts – Contract holder has ability to direct funds to one or more separate account investment alternatives maintained by the insurance entity; and investment performance, net of contract fees and assessments, is passed through to the contract holder. We agree that classification as a “separate account” or “legal insulation from general account liabilities” should not be required to identify these contracts.

Benefits – Insurance entity provides a benefit protecting the contract holder from adverse capital market performance pertaining to equity risk, interest risk or foreign exchange risk. We agree that “insurance risks” (e.g., mortality) should not be captured in the assessment of capital market risks.

Deferred Acquisition Costs (Questions 15-17)

U.S. regulators agree that the U.S. GAAP guidance for deferred acquisition costs improved significantly with the issuance of *ASU 2010-26, Financial Services—Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (ASU 2010-26)*, and the restrictions to only capitalize incremental direct costs related to certain acquisition activities. Although acquisition costs continue to be expensed immediately under statutory accounting, we agree that the proposed exposure draft revisions will further improve accounting for these capitalized expenses by requiring amortization in proportion to the amount of insurance in-force, or on a straight-line basis. We highlight that the use of insurance in-force (or a straight-line approach) is an improvement in determining amortization timeframe, but would also recommend that the FASB consider comments from industry on additional alternatives to amortization. We also agree with the immediate reduction of deferred acquisition costs in response to unexpected contract terminations (as the deferred acquisition cost no longer represents a future benefit from a successful contract), which would prevent the need for impairment assessment for these sunk costs.

Presentation and Disclosure (Questions 18-19)

U.S. regulators support the proposed reconciliation disclosures as the format and components will provide key information on fluctuations from beginning reserve balances to ending reserve balances, allowing for more detailed comparison of factors impacting reserves across different companies. We believe that enhanced detail will provide significant benefit to financial statement users and the comparisons of insurance entities, and recommend consideration of preparer comments in determining the level of disaggregation feasible to be completed.

Effective Date and Transition / Costs and Complexities (Questions 20-23)

U.S. regulators believe that information on the key drivers affecting implementation, transition provisions and costs of adopting the proposed amendments (transition costs and cost of ongoing application) would be best addressed by insurance company preparers.

Thank you for your review and consideration of this comment letter. Should you have any questions, please contact me at 614-728-1071, or NAIC staff Julie Gann (816-783-8966).

Sincerely,

A handwritten signature in cursive script, appearing to read "Dale Bruggeman".

Dale Bruggeman
Chair, NAIC Statutory Accounting Principles Working Group