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File Reference No. 2016-330
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14 December 2016

Proposed Accounting Standards Update, *Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts* (File Reference No. 2016-330)

Dear Ms. Cospers,

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Targeted Improvements to the Accounting for Long-Duration Contracts*, (proposed update or proposal) issued by the Financial Accounting Standards Board (FASB or Board).

We support the Board's objective to simplify and enhance the financial reporting requirements for long-duration contracts issued by insurers and believe many of the proposed amendments would meet that objective. However, we have concerns about certain aspects of the proposal.

We believe that when determining the scope of the market risk benefit guidance, the Board should consider the characteristics of benefit features rather than whether a benefit feature is offered with a variable product, because other arrangements may have similar fundamental characteristics. We are concerned that benefit features in variable products and in general account products that are economically similar would be recognized, measured, presented and disclosed differently under the proposal.

We agree that the FASB should make targeted improvements to the guidance on measuring the liability for participating contracts, but we do not believe the proposed amendments would result in an appropriate measurement of the liability. If certain components of the model are not changed, we believe participating contracts should be excluded from the scope of the targeted improvements. Specifically, we believe the development of the discount rate for participating contracts should consider the expected dividends to be paid to policyholders.

We agree that disclosures beyond the limited ones that are required today would allow the users of the financial statements to better understand the amount, timing and uncertainty of cash flows for long-duration contracts. However, as discussed in Appendix A below, we have concerns about the extent of the new disclosures in the annual and interim financial statements and whether all of the proposed disclosures would provide meaningful information.



We believe the Board should consider additional practical expedients for transition, specifically for market risk benefits.

Appendix A of this letter contains our responses to selected questions in the proposal. In Appendix B, we provide additional feedback for other significant components of the accounting model for long-duration contracts.

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We would be pleased to discuss our comments with the Board or the FASB staff at your convenience.

Very truly yours,

Ernst & Young LLP

Appendix A – Responses to questions raised in the Proposed Accounting Standards Update, Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts

Liability for future policy benefits – contracts other than participating contracts

Question 1: 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?

Yes. We agree with the scope of the proposed amendments on the accounting for the liability for future policy benefits for traditional long-duration contracts and limited payment contracts.

Question 2: 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?

We understand the Board could select a retrospective or prospective approach to calculate the effect of updating cash flow assumptions. We believe that calculating the effect of changes in cash flow assumptions using a retrospective approach would result in a current estimate of the liability that reflects revised future expected cash flows and actual cash flows. In addition, a retrospective approach would align the assumptions included in the measurement of the liability of existing contracts with the initial assumptions included in the measurement of the new contract liabilities.

A retrospective approach would be more complex than a prospective approach. The Board should perform outreach with preparers to better understand whether a prospective approach would reduce the operational challenges while resulting in a reasonable liability measure. We believe a prospective approach would be a reasonable compromise if the Board determines it would be a more practical solution.

Other comments related to the net premium model

We agree with the Board's decision to retain the net premium model to measure the liability for future policy benefits. In addition, we agree with the Board's decision to require all assumptions used to calculate the liability for future policy benefits for traditional long-duration and limited payment contracts to be updated.

We agree with the Board's decision to eliminate the requirement to perform a premium deficiency or loss recognition test because the proposed model uses current assumptions. We also agree with the Board's decision to prevent insurers from deferring losses to future periods by capping the net premium ratio at 100%. We agree that the liability for future policy benefits should be floored at zero (i.e., a contra liability or an asset should not be recorded).

The proposal refers several times to the "level of aggregation at which reserves are calculated," which implies that entities may need to reevaluate how they determine the level of aggregation. Under current practice, the liability measurement for direct business is generally performed on a seriatim basis (i.e., at a contract level), although the assumptions are determined at a more aggregated level, such as product type and cohort, and then applied to the contract level. While we do not believe that

the Board intended to require a change in how entities determine the level of aggregation at which reserves are calculated, the Board should clarify whether it intends to allow current practice to continue. The Board should provide guidance on the level of aggregation when an insurer would have to floor the liability for future policy benefits at zero under the proposed requirements.

We believe the Board should clarify what is meant by immediately recognizing changes in experience as referenced in 944-40-35-6A. We suggest that the Board add examples to illustrate how changes in experience would be recognized, such as when there is an insurance event before the expected event and when the insurance event did not occur when expected but would occur in the future. The examples should clearly illustrate the effect on future assumptions when actual experience is different from expected experience.

We believe the Board should modify the guidance on how the cumulative catch-up adjustment should be determined. Specifically, 944-40-35-6A indicates that the updated liability for future policy benefits (i.e., based on a revised net premium ratio that is calculated using updated cash flow assumptions and the discount rate from contract inception) must be compared with the carrying amount of the liability for future policy benefits. The term "carrying amount" is generally considered the balance recorded in the statement of financial position. However, the liability balance recorded in the statement of financial position includes updated discount rate assumptions.

If an insurer uses the carrying value to calculate the cumulative catch-up adjustment, part of the change in the discount rate would be recognized in income. We believe the Board's intent is for insurers to compare the liability for policy benefits based on updated cash flow assumptions and the discount rate from contract inception with the calculation from the previous period using the contract inception discount rate to determine the cumulative catch-up adjustment that should be recorded in income. We recognize that the implementation guidance includes an example that is consistent with how we understand the cumulative catch-up adjustment should be determined, but we believe the guidance in 944-40-35-6A should be updated to clarify how to determine the cumulative catch-up adjustment.

Question 3: 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?

Yes. We agree with the Board's decision to update cash flow assumptions annually, at the same time each year, or more frequently if there is evidence that the assumptions should be revised.

Question 4: 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?

We recognize that an insurer is obligated to perform on its benefit obligations regardless of its investment strategy, and, therefore, we understand the Board's desire to have the insurer use a discount rate that is not linked to its investment experience. We also agree that the proper rate to discount the liability is a liability rate or a rate that is implicit in the insurance contract based on its expected cash flows.

We recognize that determining a liability rate is complex, and using a high-quality fixed-income instrument yield (high-quality rate) as a proxy to the liability rate may not, in many cases, reflect the characteristics of the liability. We also recognize that the Board's decision to require the use of a high-quality rate would be a practical expedient that would provide consistency among insurers. Therefore, it would be a reasonable compromise if the Board decides to require a high-quality rate or another observable rate that would be more consistent with the cash flow characteristics of the liability.

If a high-quality rate is used to discount the liability, a loss would be recognized at contract inception for certain products, and this would not represent the economics of the arrangement between the policyholder and the insurer. Generally, the premium charged reflects the insurer's expected investment yield which would typically be higher than the high-quality rate that would be used to measure the liability. Therefore, using a high-quality rate for certain contracts will create a loss at inception. The Board should consider whether a day-one loss solely as a result of time value of money is appropriate.

Finally, if the Board decides to retain the high-quality rate to discount the liability, the guidance in ASC 944 should reference the relevant guidance in ASC 715, *Compensation - Retirement Benefits*. If the Board did not intend on the determination of the high-quality rate under ASC 944 to be the same as that under the guidance in ASC 715, the Board should consider explaining the differences.

Question 5: 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?

Yes. We agree with the Board's decision to require insurers to recognize the effects of updating the discount rate assumptions in other comprehensive income (OCI). Because the discount rate would fluctuate based on market conditions, this presentation would reduce the potential volatility in the income statement from these changes. This would also isolate the changes in underwriting results from the changes in the discount rates.

Recognizing the effects of updating the discount rate assumptions in OCI will also minimize accounting mismatches that would arise from different accounting for the assets backing the liabilities (i.e., most insurers recognize the majority of their invested assets at fair value through OCI).

Other comments related to the recognition of the discount rate assumption

We generally agree with the Board's decision that the liability for the unpaid claims and claim adjustment expense (CAE) should be discounted using the same rates used for the previously recorded liability for future policy benefits. We also agree that the effect of changes in the discount rate assumptions from the rate used at the contract issue date to the current rate should continue to be recognized in OCI.

However, the proposal only provides guidance for the discounting of the unpaid claims and CAE liability when this liability is reclassified from the liability for future policy benefits. The guidance for unpaid claims and CAE does not address those instances where a reclassification from the liability for future policy benefits does not occur or where a liability was not previously recorded. We believe the guidance on measuring the liabilities for unpaid claims and CAE should be consistent regardless of whether an amount is reclassified from the liability for future policy benefits.

The Board also should consider providing a practical expedient that would allow insurers not to discount the unpaid claims and claim adjustment expense if it expects, at the date that the claim is incurred, the period between that date and when it will pay the claim will be one year or less.

The Board also should clarify how to determine the contract inception date when there are renewals of long-duration contracts with premium changes. For example, a long-term care contract may commence 20 years before a claim is incurred. Over that 20-year period, when the policyholder renews the contract the insurer may change the annual premium as it considers revised future expectations. It is unclear whether the contract issue date is considered the date at which the contract renewed or when the contract commenced.

Question 6: 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?

Yes. We agree the discount rate assumptions should be updated at each reporting period.

Other comments related to the updating of the discount rate assumption

Because the Board decided that the interest accretion rate should be based on the discount rate at contract inception, updating the discount rate each period could require insurers to maintain quarterly cohorts. This could be overly burdensome. We believe the Board should consider a practical expedient that would allow insurers to use one discount rate for the accretion of interest for all contracts written within a calendar year. This rate could be based on a weighted average rate, the beginning of the year rate or the end of the year rate. This would allow insurers to track cohorts on an annual basis.

Liability for future policy benefits – participating contracts

Question 7: 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?

We agree that the proposed update should include targeted improvements to the measurement of the liability for participating contracts, including closed block contracts. However, we do not believe the proposal would result in an appropriate measurement of the liability and thus, if certain components of the model are not changed, we believe participating contracts should be excluded from the scope of the targeted improvements.

Participating contracts provide policyholders with certain guaranteed and discretionary benefits and dividends that are paid periodically and reflect the insurer's experience and performance of investment activity, mortality and contract administration for each contract class. Any changes in cash flow assumptions from underwriting (i.e., mortality or terminations) will directly affect the dividend assumptions such that the overall cash flow assumptions (i.e., both underwriting and dividend assumptions) will remain generally the same despite changes in assumptions and/or past experience.

For example, if actual mortality experience is worse than expected, the expected amount of dividends to be paid to the participating policyholders will decrease, reflecting the total amount of cash that is available to be paid. Changes in investment performance also affects the dividend assumptions but is not offset by other assumption changes and therefore, affects the amount of cash flows expected to be paid to participating policyholders. For example, participating policyholders can expect a larger payout over time when investment performance exceeds expectations barring adverse development in the underwriting components.

The proposal would not reflect the relationship between the different assumptions in the model and would ignore the effect of investment performance on those assumptions, resulting in a liability that does not reflect the insurer's expectations of its obligation to its policyholders. The net premium liability should be discounted using a rate that reflects the dependence of the expected cash flows and the insurer's investment performance. This would allow the liability to better reflect the insurer's expected insurance and dividend obligations measured in the net premium liability.

The recognition of changes in the dividend assumptions should be consistent with the recognition of the changes in the discount rate. To achieve this, the interest accretion rate could be adjusted when the expected dividend assumptions change if the change is a result of changes in investment performance. Reflecting the changes in the dividend assumptions in net income (given that the dividend assumptions are included in the net premium model) and the changes in the discount rate in OCI would not reflect the dependence of the different assumptions in the model resulting in a presentation mismatch.

Closed blocks

When an insurer goes through a demutualization, a closed block will generally be established for participating insurance policies to protect the participating life insurance policyholders from the competing interests of stockholders. Generally, the closed block assets and cash flows provided by those assets will be used to benefit the closed block policyholders and will continue in effect until the date on which none of the policies in the closed block remains in force, unless the insurance department consents to an earlier termination.

Because the insurer's obligation is equal to the closed block assets, at a minimum, the Board should consider a simplified model to measure the liability for future policy benefits at the carrying value of the closed block assets. This would be consistent with today's guidance that requires the measurement of the separate account liabilities to be equivalent to the measurement of the separate account assets. In both separate account products and closed blocks, assets are segregated from the general account and the investment returns inure to the policyholders.

If the assets in the closed block are not sufficient to fulfill all the obligations to the policyholders, insurers will have to use funds from outside the closed block assets to meet the contractual benefits of the closed block policyholders. The Board could require a closed block adequacy test to be performed annually and a liability to be recorded for the amount that the expected cash flows exceeds the measurement of the closed block assets. Additional disclosures that include components of the loss recognition test could provide useful information about the performance of the closed block.

Notwithstanding our comments above, if the Board were to exclude closed blocks from the targeted improvements, we recommend that it clarify the effects that the proposal would have on the accounting for the policyholder dividend obligation (PDO) in ASC 944-805. Specifically:

- ▶ Paragraphs 944-805-55-6 through 55-13 in current guidance provides an example on how an insurer should calculate the PDO. The example infers that an estimated gross margin (EGM) is needed to calculate the PDO. If these sections of the example are removed as the Board proposes, it is unclear how the inputs in the PDO calculation would be derived.
- ▶ The Board should clarify whether the assumptions in the PDO should be updated in subsequent periods similar to the liability for future policy benefits.

Question 8: 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?

Please see our response to Question 2.

If the Board decides to require insurers to calculate the effect of changes in cash flow assumptions using a retrospective approach for traditional long-duration and limited payment contracts, we believe the same approach being applied to participating contracts would be a reasonable approach.

The Board also should consider providing a practical expedient to allow the net premium model to be updated on a prospective basis for participating contracts. As previously noted, any changes in cash flow assumptions from underwriting will directly affect the dividend assumptions such that the cash flow assumptions will remain generally the same despite changes in assumptions and/or past experience. Calculating the effect of changes in cash flow assumptions using a prospective approach instead of a retrospective approach would not change the expected cash flows.

As discussed in our response to Question 7, the recognition of changes in the dividend assumptions should be consistent with the recognition of the changes in the discount rate.

Question 9: 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?

Yes. Consistent with our response to Question 3, we agree with the Board's decision to update cash flow assumptions annually, at the same time each year, or more frequently if there is evidence that the assumptions should be revised.

However, as discussed in our response to Question 7 and 12, we believe the timing of updates to the dividend assumptions (e.g., one of the cash flow assumptions) should be consistent with the timing of updates to the changes in the discount rate.

Question 10: 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?

No. We do not agree that expected future cash flows should be discounted on the basis of a high-quality fixed-income instrument yield for the liability for future policy benefits for participating contracts.

Please see our response to Question 7.

Question 11: 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?

Yes. Consistent with our response to Question 5, we agree with the Board's decision to recognize the effect of updating discount rate assumptions in other comprehensive income.

However, as discussed in our response to Question 7, we believe the recognition of changes in the dividend assumptions should be consistent with the recognition of the changes in the discount rate.

Question 12: 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?

Yes. Consistent with our response to Question 6, we agree with the Board's decision to update the discount rate assumption each reporting date.

However, as discussed in our response to Question 7 and 9, we believe the timing of updates to the dividend assumptions should be consistent with the timing of updates to the changes in the discount rate.

Market risk benefits

Question 13: 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?

No. We support the Board's objective to simplify and improve the accounting for benefit features. However, we do not agree that the scope of the proposed amendments on the accounting for market risk benefits should be based on the contract being a variable product. There may be benefit features held in variable products and in general account products (e.g., fixed indexed annuities) that are economically similar yet these features would be recognized, measured, presented and disclosed differently. In addition, the complexities of assessing the accounting model for those benefit features offered in general account products would remain.

We believe the Board should focus on the characteristics of contracts rather than specific product types because arrangements may share fundamental characteristics. We suggest the Board perform outreach to better understand the different types of benefit features offered by insurers and determine the benefit features that should be accounted for in the same manner. Here are a few ideas that the Board could consider when evaluating these features:

- ▶ The Board could consider deriving a principle for market risk benefits based on whether the policyholder would receive the benefits of the feature due to an insurance event or at the option of the policyholder. The benefit ratio model could be applied to those benefit features that are life or death contingent and the fair value model could be applied to those benefits that are redeemed at the option of the policyholder.
- ▶ The Board could consider other accounting literature that has separation guidance for benefit features. Actuarial Guideline 33,¹ which is used for US statutory accounting, identifies benefits as either non-elective (i.e., benefits only payable to policyholder after the occurrence of an event such as a death) or elective (i.e., benefits freely elected under the terms of the contract). While these categories of benefit features were created and used for a different purpose, the categories are known by constituents.
- ▶ Since the Board's objective is to simplify the accounting for benefit features, an alternative could be to only have one accounting model for all benefit features, such as applying the benefit ratio model. If the benefit ratio model is applied to all benefit features, we believe an immediate loss recognition should be triggered if the present value of excess payments is greater than that of expected assessments.

Notwithstanding our comments above, if the Board decides that the market risk benefit guidance should apply only to variable products, we believe the Board should reference the criteria within ASC 944-80-25-2 that would be used to determine whether the benefit features are to be accounted for under the market risk benefit guidance in 944-40-25-25C.

The ASC Master Glossary defines market risk benefit as a long-duration contract benefit that meets two criteria, one of which requires the insurer to maintain the separate account investment alternatives. Whether this includes situations in which insurers use third-party administrators to maintain the separate accounts is open to interpretation. We believe the term "maintained" should be removed and replaced because the accounting should not be different based on when the insurer maintains the separate account alternatives or uses a third party.

¹ National Association of Insurance Commissioners, Actuarial Guideline XXXIII, *Determining CARVM Reserves For Annuity Contracts With Elective Benefits*

Question 14: 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?

Yes. Notwithstanding our response to Question 13, we believe that benefit features that are not accounted for using today's benefit ratio model should be measured at fair value. If a benefit feature is recorded at fair value, we agree that changes in the fair value attributable to a change in the instrument-specific credit risk should be recognized in other comprehensive income. This treatment is consistent with the targeted improvements in ASU 2016-01.²

In general, we believe the determination of a measurement model for a benefit feature should not depend on whether an entity applies or intends to apply risk mitigation techniques, such as hedging. If the Board wants to minimize accounting mismatches between the benefit feature and the hedging instrument, it could allow a fair value option for measuring the benefit feature rather than select a measurement model purely because an insurer may hedge the feature.

The proposed 944-40-30-19B would require market risk benefit features to be measured separately from the host contract (e.g. the variable annuity contract). The measurement of the market risk benefit feature would be fair value using either the non-option valuation approach or the option-based valuation approach, which is consistent with the measurement of embedded derivatives in the scope of ASC 815. To minimize diversity, the Board should specify the criteria for the benefit features to be bifurcated from the host contract at the initial measurement date within ASC 944 rather than reference valuation approaches in ASC 815. This would be consistent with the Board's intent to measure all market risk benefits in accordance with ASC 944.

The objective of the measurement could be to calculate the fair value of the benefit feature, which should be equivalent to the cost an insurer would incur to exit its guarantee or obligation (i.e., the amount an insurer would pay a third party to be relieved of its guarantee). The fair value measurement could be calculated as the difference between the expected value of payments pursuant to the benefit feature with an appropriate risk premium and the expected value of future fees the insurer would collect for the benefit feature. Because at contract issuance the fees to be charged to the policyholder are meant to represent the price for the guarantee, it would be anticipated that the expected value of payments plus an appropriate risk premium generally would equal the expected value of fees (or the price an insurer would pay a market participant to assume the guarantee obligation). Accordingly, the fair value of the market risk benefits at contract issuance would be zero because the entity assumes a portion of the overall contractual fee is intended to be the premium for the benefit. This is an approach used in current practice, often referred to as the attributed fee approach,³ to value benefit features accounted for as embedded derivatives under ASC 815.

² FASB's ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*

³ This approach is generally meant to apply the guidance from the FASB's Statement 133 Implementation Issue No. B20, *Embedded Derivatives: Must the Terms of a Separated Non-Option Embedded Derivative Produce a Zero Fair Value at Inception*.

Deferred acquisition costs (DAC)

Question 15: 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?

Yes. We understand that the Board's intent is to simplify the amortization of DAC. However, we believe there is also an opportunity to simplify the accounting for investment contracts. We suggest the Board consider modifying the guidance to require investment contracts to be accounted for in their entirety as interest-bearing financial instruments under ASC 310-20⁴ (formerly known as FAS 91⁵) or as contracts written by insurance entities under ASC 944.

The current guidance for investment contracts was established with the adoption of FAS 97⁶ and is a hybrid of the accounting for insurance contracts in the scope of ASC 944, given that these contracts are sold by insurers, and financial instruments in the scope of ASC 310, given the Board's belief that investment contracts are more similar to financial instruments issued by other financial institutions than to insurance contracts.

We believe that accounting for investment contracts in their entirety under one model (i.e., ASC 310-20 or ASC 944) with guidance that addresses all components of the investment contract (i.e., recognition and measurement of the liability, capitalization and amortization of DAC and recognition of revenue) would be a simplification of today's accounting. It is important to note that there is no direct revenue recognition guidance in current GAAP for investment contracts and the industry applies the fee guidance for universal life-type contracts under ASC 944 because there is a lack of revenue recognition guidance for investment contracts.

Question 16: 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?

Yes. We agree with the Board's objective to simplify the amortization of DAC but believe certain items should be clarified in the proposal.

While the proposal indicates that DAC should be recognized over the life of the contracts, the objective for the recognition of DAC expense in the income statement should be clarified.

The Board should also clarify the basis for the straight-line method, including whether its intent is for DAC to be amortized on a straight-line basis over the expected term of the contract or whether some other basis would be acceptable, such as straight line over the number of contracts outstanding.

⁴ FASB's ASC 310-20, *Nonrefundable Fees and Other Costs*

⁵ ASB's Statement of Financial Accounting Standards No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*

⁶ FASB's Statement of Financial Accounting Standards No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*

The Board should also clarify whether the term “amount of insurance in force,” as used in paragraph 944-30-35-3A would only apply to insurance products, or whether an analogy could be made to terms more commonly used for annuities such as account value or net amount at risk.

In addition, the Board should clarify whether the method initially selected to amortize DAC should be applied in all subsequent periods or whether there are situations in which an insurer could switch methods.

We believe the proposal would allow an entity to calculate the amortization of DAC on a contract level or, if there is a homogenous pool of contracts with similar characteristics, on a cohort level. If this is not consistent with the Board’s intent, the Board should clarify the unit of account at which the amortization model should be applied.

Other comments related to the amortization of DAC

The proposed DAC amortization model would also affect the amortization of other assets, including deferred sales inducement (DSI) costs and unearned revenue liabilities, because the guidance for these assets refers to the DAC amortization guidance. Many insurers also amortize the intangible value of business acquired (VOBA) using the DAC amortization model. In addition, current ASC 944 guidance indicates that the cost of reinsurance should be amortized in a consistent manner as the underlying contract. The Board should consider how its decision on the amortization of DAC affects these other balances. While today’s guidance for amortizing DAC may be appropriate for the recognition of these other balances, the proposed model for amortizing DAC may not be appropriate for these balances.

The reduction of DAC under proposed paragraph 944-30-35-3B refers to unexpected terminations and does not refer to the continuation of amortizing DAC when a replacement contract is substantially unchanged from the replaced contract included in 944-30-35-46 and 35-47. We suggest that a reference to paragraphs 944-30-35-46 and 47 be made in paragraph 944-30-35-3B because some preparers may believe that the replaced contract was terminated and the replacement contract was then issued.

Question 17: 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?

No. We believe DAC (and related balances such as value of business acquired and deferred sales inducements) should be subject to impairment testing, consistent with other assets.

To determine an appropriate impairment model for DAC, the Board should clarify the objective for the recognition of DAC expense in the income statement as we explained in our response to Question 16.

We understand that one of the objections to impairment testing is that it adds complexity to the model. However, the Board could consider a simplified impairment model. For example, DAC for traditional long-duration, limited payment and participating contracts could be reduced if the net premium ratio is capped at 100% for the liability for future policy benefits.

As previously discussed in our response to Question 16, the proposed accounting for DAC would also affect the accounting for other assets, including DSI, unearned revenue liabilities and potentially VOBA. The Board should separately consider whether these other balances should be subject to impairment testing.

Under current practice, VOBA and DAC are often assessed together for impairment. It is not clear whether the Board intends to eliminate the impairment test for VOBA or whether an insurer would apply the impairment guidance from another standard such as that included in ASC 350-30⁷ and ASC 360-10⁸.

Presentation and disclosure

Question 18: 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?

We agree with the Board's intent to make disclosures more effective since today's disclosure requirements provide limited information about the exposures of an insurer and the amount, timing and uncertainty of cash flows from long-duration contracts. We believe rollforward disclosures for the insurance-related balances would provide meaningful information to the users of the financial statements about changes in the asset or liability balances.

Although the proposal would provide a principle for the level of disaggregation of information, for a multi-line, multi-location writer of insurance contracts, the disclosures could be overwhelming. We recommend the Board evaluate the disclosures required by ASU 2015-09, *Disclosures about Short-Duration Contracts*, which will be included in public business entities' annual financial statements as of 31 December 2016. We acknowledge that the disaggregation of the information under the proposal would also follow disaggregation principles in the new standards on revenue recognition, leases and measurement of credit losses on financial instruments. However, the Board should separately consider each of the projects and whether that same level of disaggregation provides meaningful information to the users of the financial statements. The Board should also consider whether the costs to provide this disaggregated information outweighs the benefits, specifically for nonpublic insurers.

We are concerned that requiring all of the disclosures to be provided on an interim basis will be burdensome to insurers and could become a series of account balance rollforward amounts or tables with limited commentary on the causes of differences between actual insurance events occurring versus the expected events when entities do not update their cash flow assumptions in an interim period. It also may result in generic commentary in the interim financial statements on the qualitative and quantitative information about the significant inputs, judgements and assumptions. ASC 270, *Interim Reporting*, indicates that the usefulness of interim financial information rests on the relationship that it has to the annual results of operations. Each interim period should be viewed primarily as an integral part of an annual period. Therefore, the guidance in ASC 270 sets forth minimum disclosure requirements for interim financial reports and indicates the types of disclosures

⁷ FASB ASC 350-30, General Intangibles Other Than Goodwill

⁸ FASB ASC 360-10, Overall

needed to be made on a meaningful basis for a period of less than a full year. Applying this principle, it may be more appropriate for the proposed disclosures to be provided only when there is a significant change since the prior annual financial statements.

It is unclear whether the disclosures could be presented gross or net of reinsurance ceded. The example provided in 944-40-55-29E includes a line item for reinsurance recoverables (as required in 944-40-50-6b3) that could indicate a net presentation would be required, at a minimum for the rollforward of the liability for future policy benefits. The Board should consider the basis on which management analyzes the results to then clarify in the proposal whether these disclosures should be gross or net of reinsurance ceded.

We also do not believe the disclosure requirements of ASC 944-40-50-6, which appear to be applicable to those liabilities measured using the net premium liability approach, are applicable to the additional liability for annuitization, death or other insurance benefits, which is measured using the benefit ratio model. We recommend the Board develop separate disclosure requirements that would be more applicable to these types of benefit features and the measurement model being applied.

We do not believe disclosing weighted-average information at either an aggregate or disaggregate level for the liability for future policy benefits and market risk benefits would provide meaningful information to the users of the financial statements. If the Board believes that disclosing weighted-average information allows users to better understand future cash flows, we believe the Board should expand the illustrations in ASC 944-40-55 to present this information and also provide preparers with additional guidance to enable them to decide how they would need to disaggregate the information to meet the disclosure requirements.

There could be confusion about which disclosures would be needed for specific products. For example, 944-40-50-7A requires a disclosure for the liability for policyholder account balances as described in 944-40-25-14. However, this paragraph is specifically in the context of universal-life type contracts, which would exclude general account annuity contracts (e.g., fixed deferred annuities and fixed indexed annuities). It is unclear whether the general account liabilities annuity contracts should be included in any of the new disclosures. In addition, for some products, certain elements of the disclosure requirements from the different categories of liabilities may be applicable.

The Board should clarify the guidance in paragraph 944-40-50-7B to state that the disclosures for market risk benefits should provide information disaggregated by type of market risk benefit but not disaggregated below the measurement of the market risk benefit. The measurement guidance in 944-40-25-25C states that if a contract contains multiple market risk benefits, those market risk benefits have to be bundled together as a single, compound market risk benefit. If these market risk benefits are combined for measurement purposes, they should be combined for disclosure purposes. It would be unduly burdensome to require insurers to separately calculate different types of market risk benefits that are combined for measurement only for disclosure purposes.

It is not clear why the disclosure requirements for benefit features classified as market risk benefits should be different than those required for benefit features classified as embedded derivatives, because both are measured at fair value. The Board should clarify whether the disclosures of market risk benefits in the proposal are meant to be similar to those for fair value liabilities under ASC 820. The Board should provide an explanation on how these disclosures would be applied to these benefits or the reason for the inconsistency in disclosures for liabilities held at fair value.

We are concerned the disclosure requirements for inputs, judgments and assumptions would lead to boilerplate disclosures because of the number of inputs, judgments and assumptions that an entity would use in the measurement of the liability for future policy benefits. We believe it would be more effective to require the disclosure of significant changes to inputs, judgments and assumptions in the context of the related liability balance, consistent with ASU 2015-09.

The Board should perform further outreach with preparers and analysts to determine the usefulness of these specific disclosures considering the various types of products written by insurers. This analysis should consider whether the information is useful when different products and cohorts are aggregated at a reasonable level for presentation in the financial statements.

Finally, as part of this project, the Board should perform an overall review of all the disclosures that would be required for long-duration contracts in ASC 944. The purpose of this evaluation would be to determine whether the disclosures in their entirety (including the new disclosures in the proposal) would provide meaningful information to users of the financial statements.

Other comments related to presentation

We do not agree with the requirement to present market risk benefit liabilities separately in the statement of financial position because this would give prominence to these benefit features over other benefit features that are accounted for using the benefit ratio model or ASC 815. However, there should be a required disclosure to indicate which financial statement line item such benefit features are captured in.

Question 19: Are there any additional presentation or disclosure requirements that would provide decision-useful information? If so, please describe them and explain why.

Please see our response to Question 18. We suggest the Board expand the requirement for insurers to disclose qualitative and qualitative information about objectives, policies and processes for managing risks for the liability for policyholder account balances and market risk benefits to all insurance contract liabilities. In addition to specifying that these disclosures should include information about hedging activity undertaken to manage capital market risk, the Board should specify that the disclosure should include information about reinsurance. This information could provide meaningful information to the users of the financial statements because many insurers manage their risk through reinsurance.

We believe disclosures should focus on providing information that supplements the amounts reported in the financial statements, and disclosures about objectives, policies and processes for managing risks for the liability are better placed in other communications provided to users, such as Management's Discussion and Analysis. We believe the information in the disclosures to the financial statements should relate to risk-mitigating factors that have a financial effect.

Effective date and transition

Question 20: 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?

We expect that the key drivers affecting the timing of implementation are system changes. Changes to processes and the implementation of controls will also be time consuming. In addition, because the reported amounts may differ significantly from those reported under existing US GAAP (and this may change many key performance indicators), educating internal and external users of the financial statements prior to the implementation of the proposal will take time.

How these key drivers affect the time it will take to implement the proposed amendments will vary by company. The Board should consider input from preparers of different sizes and preparers that write different products.

In recently issued guidance, the Board has provided nonpublic entities an additional year to adopt new guidance. We believe this precedent should be applied to this proposal. As noted above, the key drivers in implementing the proposed guidance are system and process changes that may be more significant for nonpublic entities that may not have as many resources. In addition, many nonpublic insurers have historically learned from the adoption of accounting standards by public insurers.

We recommend that the Board expand the one-year deferral for nonpublic entities to life insurers that are non-issuers but are deemed public business entities because the annual financial statements are included in registration filings with the SEC for separate accounts. This transition and effective date approach would be similar to ASU 2016-13.

Question 21: Are the proposed transition provisions operable and do they provide decision-useful information? If not, what would you recommend and why?

We believe the transition provisions need to result in the measurement of long-duration contracts written before and after the transition date in a manner that will result in consistent revenue, expense and profit recognition patterns. We generally believe the proposed transition requirements would best achieve those objectives.

The proposed transition provisions for the measurement of the annuitization, death or other insurance benefits are unclear. We believe the Board's intent was to apply the revisions on a retrospective basis, which should be clarified in the guidance.

The Board should consider providing a practical expedient for the transition requirements for market risk benefits when it is impracticable to obtain the underlying data or the benefit liability was not previously recorded at fair value given that it would be difficult to not include bias in determining the fair value for prior periods. ASC 250 indicates that a retrospective approach is impracticable when the use of hindsight by management is needed (e.g., estimate of fair value based on inputs that are not

derived from observable market sources and were not used for other accounting measurements at the time). This is consistent with the transition approaches adopted by the Board in the new guidance on financial instruments classification and measurement and credit losses. If the Board decides to provide a practical expedient, it will need to determine how an insurer would measure the market risk benefit at the transition date.

As previously discussed in our response to Question 16, the proposed accounting for DAC would also affect the accounting for other assets, including DSI, unearned revenue liabilities, cost of reinsurance and potentially VOBA. The Board should separately consider the transition approach for these other balances, which in our view should be a prospective approach. Without specific transition guidance, we believe insurers would have to assess preferability when applying the proposed changes to these balances.

It is unclear whether insurers should consider changes in assumptions that were made subsequent to the initial measurement of the contract (e.g., because of loss recognition) but prior to transition. The Board should clarify whether the loss recognition date would be considered the contract issuance date for purposes of transition. Similarly, upon triggering loss recognition, DAC is generally written off as a charge to income. It is unclear whether DAC should be reestablished at an amount equivalent to what the balance would have been at the transition date had it not been written off.

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

Yes. We agree the proposed transition disclosure requirements provide decision-useful information.

However, we are concerned with the ASC 250 requirement to disclose the effect of certain changes in financial statement line items for the current year. Specifically, we believe it may be costly for insurers to continue to maintain their old model and the new actuarial model for the year of adoption (i.e., the current year). The Board should reach out to preparers and determine if the benefits of providing this disclosure for the year of adoption would exceed the costs.

Cost and complexities

Question 23: 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.

The Board should focus on the input of preparers when evaluating the additional costs of adopting the proposed amendments.

Appendix B – General comments about the proposal

We have the following additional observations and recommendations related to the proposed guidance.

Additional liability for annuitization, death or other insurance benefits

Benefit ratio capping and profits followed by losses

We believe the guidance in 944-40-30-21 and 944-40-30-26 is not clear. We believe the intent of the Board is to maintain the benefit ratio model in today's guidance and add a provision requiring the immediate recognition of a separate liability (loss recognition liability) if a loss recognition event is triggered. The benefit ratio model liability would be modified to prevent the loss from being double counted.

The Board should clarify in the loss recognition liability calculation that investment margins should be considered in the expected assessments when determining the amount of expected excess payments that exceeds expected assessments. This would be consistent with the inputs included in 944-40-30-20, 944-40-30-22 and 944-40-30-26 through 30-27.

Rather than providing a cap on the benefit ratio, the FASB should require the amount of expected excess payments that exceeds the expected assessments to be deducted from the numerator of the benefit ratio calculation (i.e., remove the excess payments that are established within the loss recognition liability).

The Board should provide guidance for how the loss recognition liability should be re-measured in subsequent periods. We believe the Board intended for an insurer to perform the loss recognition test each reporting period and recognize an increase or decrease to the previously established liability based on the difference between the current and prior period calculations. However, without clear guidance in the proposal there could be diversity in interpretation.

We also suggest the Board remove references to the concept profits followed by losses in the context of the annuitization, death or other insurance benefits in 944-40 (e.g., 944-40-25-27 and 944-40-25-7A) since this loss recognition test would describe the triggering event for loss recognition to occur when excess payments are greater than assessments.

Other

It is unclear in the proposal whether the contract rate used for discounting in the measurement of the additional liability would be an accounting policy election between the contract rate from the inception date or the latest revised rate or whether the latest revised rate should only be used if a revision occurred.

Clarifications needed in ASC 944

ASC 944 is a compilation of numerous standards developed over time as new insurance products emerged. As a result of this combination of standards, there are instances where guidance was left out, words were changed and/or the linkage of the guidance to specific products is not accurate. Constituents refer to the original guidance but may come to decisions that are not in accordance with the original

guidance when applying the guidance as written in ASC 944. We recommend that in conjunction with a final Accounting Standards Update, ASC 944 be reorganized so it is more comprehensible to the FASB's constituents. We would be willing to provide suggestions and specific examples.

Other feedback for the liability for future policy benefits

We suggest removing paragraph 944-40-25-11 since the standard describes the measurement guidance, and information on how one might view the liability is not necessary. This concept was included in the definition of the term "liability for future policy benefits" in the pre-Codification standard, however, that term has subsequently been defined in the Master Glossary.

The calculation of the liability for future policy benefits would significantly change from current guidance because it would require a retrospective calculation. However, that is not clear in all of the references to the calculation. For example, paragraph 944-40-30-7A indicates an immediate charge to income is recognized if the present value of future benefits and expenses exceeds the present value of future gross premiums. Another example is in paragraph 944-40-55-29E that refers to the two components as "present value" amounts, suggesting the calculation would not include actuals from the contract to date. Since this is a retrospective calculation, we believe it would include actuals for the contract to date and the present value of future expected experience, which would not be clear in the proposal. The Board could consider the language used in the estimated gross profits model to clarify the guidance.

The proposal does not indicate which date should be considered the contract inception date for the calculation of the liability for future policy benefits when an insurer (or reinsurer) assumes a block of business.

Other feedback for benefit features

Paragraph 944-40-25-25B refers to "all other contract features." The Board should clarify whether such features include certain benefit features that are not accounted for using the benefit ratio model under today's guidance.

We suggest deleting the phrase in paragraph 944-40-30-20 "excluding those assessments included in the measurement of market risk benefits." An insurer would first apply paragraph 944-20-25-25B to determine which cash flows to associate to each of the three models for benefit features. Including this phrase to exclude assessments included in the measurement of market risk benefits and not those assessments included in the measurement of embedded derivatives could be confusing to preparers. In addition, it would be duplicative if paragraph 944-40-30-20 were modified to exclude the assessments included in the measurement of market risk benefits and embedded derivatives.

The example in the second sentence of paragraph 944-40-35-18 should be clarified or removed. The first sentence in this paragraph was broadened to refer to guidance associated to market risk benefits, death or other insurance and annuitization benefits. However, the second sentence, which includes an example, is specific to a guaranteed minimum death benefit on a universal life-type contract and should only be referenced to the death or other insurance benefits guidance since it could never meet the scope for market risk benefits as drafted in the proposal (see our comments to Question 13).

In accordance with 944-40-35-21, an insurer may recognize a gain upon annuitization of a contract due to a change in the discount rate from the contract rate to a rate based on the high-quality fixed-income instrument yield. Generally, US GAAP does not allow an entity to recognize a gain upon entering into a contract or when an entity settles a contract by replacing it with a new contract. If it is not the Board's intent for an insurer to recognize a gain in these situations, the Board should provide guidance on deferring and recognizing such a gain.

The market risk benefit rollforward in ASC 944-40-55-29G should only include one column of cash flows and not be split between attributed assessments and benefit payments.

The proposal would modify ASC 815-10-15-13 to include "market risk benefits" since these features would not be classified as embedded derivatives. The FASB should provide context on market risk benefits in ASC 815-10-15, consistent with all the other topics covered in 815-10-15-13.

ASC 815-15-55-55d should be modified as follows: "...that are market risk benefits accounted for under Topic 944 ~~on insurance~~ are not within the scope of this Topic." Market risk benefits may be offered on investment contracts and referencing only insurance contracts could cause confusion.

The proposal would remove the guidance in ASC 944-20-55-22 and 55-23 and 815-15-55-57 through 55-61, which addresses benefit features associated to variable products. However, this guidance is also used when assessing benefit features in general account products, such as fixed indexed annuities. We suggest retaining this guidance and modifying it to reference nonvariable products.

Other feedback

ASC 944-30-35-3C should be clarified to indicate whether the "incurrence of those costs" indicates when those costs are paid or when expensed.

The guidance in paragraph 944-40-25-40 is not clear. The Board should separately address the accounting by the ceding entity and the accounting by the reinsurer.

In the proposal, paragraphs 944-40-55-29E, 55-29F and 55-29G provide examples for the proposed disclosures. However, these paragraphs indicate that the insurer "should" disclose the items listed in the example, indicating that an insurer "must" disclose these items, albeit these items are not included in the guidance in ASC 944-40-50. We believe these paragraphs are meant to be examples, and, therefore, the Board should clarify that the insurer "could" disclose the items listed.

The proposal would modify ASC 944-60 to remove the guidance on long-duration contracts relating to premium deficiency testing and loss recognition. All titles should be updated to only reference short-duration contracts and not be classified as "general".

In the proposal, paragraph 944-605-35-1B would describe the subsequent measurement and accounting for the deferred profit liability for limited payment contracts. Part C would refer to the changes being recognized in current-period benefit expense. Since this is a deferred revenue account as described in 944-605-25-4A, we suggest that changes be recorded as revenue. In addition, we suggest that the Board clarify what amounts would be recorded in the income statement and whether those amounts would be the amortization of the deferred revenue liability (i.e., not including the amounts deferred each period).