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December 15, 2016

Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards Board (FASB, the Board)
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update – *Financial Services--Insurance (Topic 944)*
Reference No. 2016-330

Dear Ms. Cospers:

MetLife, Inc. (“MetLife” or “we”) appreciates the opportunity to provide comments on the FASB’s Exposure Draft on the Proposed Accounting Standards Update, *Financial Services-Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts* (the “Proposed ASU”). MetLife, through its subsidiaries and affiliates, is a global provider of life insurance, annuities, employee benefits and asset management with leading market positions in the United States, Japan, Latin America, Asia, Europe and the Middle East.

We commend the Board for its efforts to improve the accounting and disclosures for long-duration contracts issued by insurance companies. The accounting for long-duration contracts has evolved through a series of targeted improvements over the past few decades with the introduction of new accounting models and even refinements to those models. This was driven by the need to keep up with the increasing variety and complexity of products and product features in the insurance marketplace. Through this evolution, standard-setters followed the goal that each change resulted in accounting guidance that more faithfully represented the underlying economics than the prior guidance. The same applies to this latest round of targeted improvements in the Proposed ASU, representing changes to insurance company accounting that would be the most significant and widespread than any of the prior changes to date.

In addition, we applaud the Board’s additional goal to reduce the complexity in the accounting for long-duration contracts, while at the same time providing more relevant, reliable and understandable information to financial statement users. While we agree that many aspects of the proposal help achieve these goals, we believe there are certain key aspects of the Proposed ASU that need to be addressed for the financial statements of life insurers to more faithfully represent the underlying economics of long-

duration contracts and to provide users with an understandable picture of the financial performance of the insurance entity from period to period. Our key concerns relate to the following:

Participating Contracts – the revised model for traditional non-participating contracts, if applied to participating contracts as proposed, would create significant non-economic accounting mismatches that need to be addressed before a final standard can be issued

Discount Rate – the use of a “high-quality” fixed-income instrument yield proposed to discount non-participating contracts does not adequately reflect the illiquidity inherent in the insurance contract liabilities, resulting in an inappropriate valuation of the liability

Prospective versus Retrospective Unlocking of Cash Flow Assumptions – the prospective method of unlocking is more operational, provides results that are easier to explain, and more clearly presents actual versus expected impacts of assumption updates

The following pages present additional details on our thoughts with respect to the key areas of accounting for long-duration contracts in the Proposed ASU as well as responses to each of the specific questions raised. We once again thank the Board for the opportunity to respond to these proposals and the consideration of our observations and comments. If there are any questions regarding the contents of this letter, please do not hesitate to contact me.

Sincerely,



Peter M. Carlson
Executive Vice President and
Chief Accounting Officer

cc: John C.R. Hele
Executive Vice President and
Chief Financial Officer

MetLife Key Observations and Comments

The sections that follow summarize our key observations and comments with respect to the accounting in the Proposed ASU and our responses to specific questions asked of respondents.

Participating Contracts

The revised model for traditional non-participating contracts, if applied to participating contracts as proposed, would create significant non-economic accounting mismatches that need to be addressed before a final standard can be issued. In particular, participating contracts have dividend crediting rates that vary over time, and the changes in crediting rate are highly dependent on the returns of the underlying assets. The proposed model is only relevant for contracts with fixed crediting rates.

In order to correct the participating contracts model, at least three issues need to be addressed:

1. The discount rates used (for balance sheet and income statement measurement purposes) need to be consistent with the assumed returns underlying the dividend crediting rates used to project liability cash flows.
2. The interest accretion rates need to vary consistently with dividend crediting rates.
3. Changes in dividend crediting rates need to be accounted for consistently with changes in discount rates (e.g., both changes through other comprehensive income (OCI) without updating the net premium ratio).

In addition, the accounting model for policies within a demutualization closed block should be simplified. Demutualization closed block policies essentially provide the policyholder the returns on the underlying assets plus additional amounts only if those asset returns are insufficient to fund contract guarantees. A much simpler and more representationally faithful accounting model than either existing or the proposed guidance would set the closed block liability equal to the reported carrying value of the closed block assets plus a provision for any asset deficiency relative to the contract guarantees.

Our responses to Questions 8 - 11 provide additional support for these positions and related proposed recommendations.

Discount Rate

We agree that the discount rate for non-participating insurance contract liabilities should be an objective, liability-based rate that is not linked to the actual or expected yield of the insurer's own assets and makes adequate provision for illiquidity. However, we are very concerned with the Board's decision to require the use of a "high-quality fixed-income instrument yield", which has been interpreted in practice in other accounting standards to refer specifically to a AA rate in the United States. Insurance liabilities are generally very illiquid and the relatively small AA spread above the risk free rate does not adequately reflect that illiquidity. Further, a AA spread is inconsistent with the rate inherent in the pricing of many insurance contracts at the time they are issued, at which point there is a market transaction. We believe a spread closer to a "single A" fixed-income instrument yield would provide a more appropriate provision for illiquidity and would be more consistent with industry insurance contract pricing in general. As such, we believe the standard should require discounting non-participating insurance contract liabilities at a rate

that corresponds or is similar to a single A rate in the United States. Our response to Question 4 provides additional support for this position and related recommendations.

Cash Flow Assumption Unlocking

We do not agree with retrospectively unlocking of the net premium ratio. We believe that cash flow assumptions should be reviewed at least annually and updated through a prospective adjustment to the net premium ratio for traditional and limited-payment long-duration contracts. While we understand the Board's rationale for adjusting the liability retroactively from a balance sheet perspective, we believe that financial statement users will be focused on understanding the insurer's financial performance for the period, including the impact of actual versus expected experience. Both the prospective and retrospective approaches involve a prospective adjustment to the net premium ratio, but only the prospective approach causes 100% of the impact of actual versus expected experience in the current period to be reflected in current period earnings. The retrospective approach requires the maintenance of a significant amount of historical data, involves significantly more onerous transition, and yields results that would be more difficult to explain to management and users. Therefore, we believe that from a cost benefit perspective the prospective approach should be adopted in the final standard. Our response to Question 2 provides more support for this position.

We also have a concern about retrospective unlocking specific to the additional liability for annuitization, death and other insurance benefits ("Additional Liability"). We disagree with the proposal to retroactively accrue an Additional Liability subsequent to contract inception when a contract is expected to generate "profits-followed-by-losses". The liability as proposed would not only accrue for the eventual expected losses, but would also include a component for retroactively changing the profit pattern of the contract from recognizing margins as they are realized to recognizing a constant percentage of assessments. This component may be significantly larger than the present value of eventual losses and potentially could create a "cliff effect" recognizing liabilities that are inconsistent with the economics of the contract. Also, the requirement to maintain historical information for all contracts to enable the possibility of such retroactive accruals could negate much of the benefit to preparers of simplifying the amortization of deferred acquisition costs (DAC) for universal life-type contracts. Our response to Question 1 discusses this issue further and we have also included additional information in an appendix that more clearly demonstrates our concern.

Market Risk Benefits

We generally agree with the proposed scope and measurement attribute for market risk benefits. It would simplify and align the accounting with any associated hedging activities, and also eliminate non-economic volatility related to changes in "instrument specific credit risk".

However, we have significant concerns with the proposed transition provisions. A full retrospective transition approach is not operational since the historical data required to determine an attributed fee that would result in a zero fair value at the inception of each contract may not be available. Additionally, it would be nearly impossible to develop the appropriate assumptions without the bias of hindsight. We believe a practical expedient or additional guidance is needed that would utilize assumptions as of the transition date, thereby alleviating these operational and impracticability issues. Our response to Question 21 provides additional support for this position and our related recommendations.

Deferred Acquisition Costs

In general, we agree with the proposed amendment to simplify the amortization DAC for long-duration contracts. The simplified method would eliminate the need for retrospective unlocking, which is complex and difficult for users to understand. We do, however, believe that DAC for long-duration contracts should continue to be subject to an impairment test similar to current guidance since DAC meets the definition of an asset and is recoverable from the net future cash flows expected to be generated by the acquired contracts at inception and on an ongoing basis. Our response to Question 17 provides additional support for this position and related recommendations.

Presentation and Disclosures

We agree with the proposed presentation requirements to include the effects changes in discount rate and instrument-specific credit risks relating to contract liabilities in OCI. We are generally supportive of the proposed disclosures but have concerns regarding certain disclosures that are duplicative with existing requirements or that may not provide decision-useful information. Our response to Question 18 provides additional support for this position.

Costs, Complexity and Effective Date

Overall, there would be many significant costs involved in adopting the proposed amendments. One-time costs include revising existing or creating new actuarial models such as those applicable to the liability for future policy benefits, amortization of DAC and valuation for market risk benefits. There would also be one-time costs for training and education. Ongoing costs include actuarial model maintenance, additional data capacity, additional actuarial staff and management, and controls (performance, documentation, and auditing).

We recommend an effective date such that the implementation period is no less than four years from the issuance of the final standard given the extensive changes associated with the proposed targeted improvements and other significant accounting standards becoming effective for insurance companies over the next several years. If the Board accepts our recommendations on prospective unlocking and simplifying transition, implementation could be completed a year earlier. In addition, early adoption should not be allowed due to the complexity of the new proposals and issues regarding comparability.

Our responses to Questions 20 and 23 provide additional support for this position.

Responses to the Proposed ASU Questions

Liability for Future Policy Benefits—Contracts Other Than Participating Contracts

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?*

Yes, we generally agree with the scope of the proposed amendments for the liability for future policy benefits for contracts other than participating contracts but have recommendations in several areas, as follows:

Liability for unpaid claims and claim adjustment expenses

It appears that the objective of the proposed amendments made to ASC 944-40-25-9 was to align the discount rates used to measure the liability for unpaid claims and claim adjustment expenses for balance sheet and income statement purposes with the proposed discount rate to be used for the liability for future policy benefits to the extent such liabilities would otherwise qualify for discounting under ASC 944-20-S99-1.

While we support this objective, we have the following recommendations:

- This section should more clearly indicate that it only applies to the liability for unpaid claims and claims adjustment expenses that would otherwise qualify for discounting in accordance with ASC 944-20-S99-1. As written, ASC 944-20-S99-1 could be interpreted to only apply to certain short-duration contracts, so we believe it is important to clarify how the Board believes ASC 944-20-S99-1 applies to long-duration contracts. The proposed amendments to ASC 944-40-25-9, if not clarified, could be interpreted to apply to all long-duration claim liabilities, which we do not believe was the intent of the proposed amendments.
- The guidance in ASC 944-40-25-9 should be clarified to also apply in situations where the liability for future policy benefits is not released upon the occurrence of the claim, which is not uncommon, depending on the reserving methodology employed and type of benefit provided. In these situations (e.g. certain disability benefits, waiver of premiums benefits), we believe it is appropriate for companies to be allowed to use the current rate at the time the claim is incurred for income statement accretion purposes instead of the rate at contract inception required by the Proposed ASU because the current rate at the time of claim incurrence would be more relevant.

Additional liability for annuitization, death, or other insurance benefits (“Additional Liability”)

We recommend that the Board consider requiring that the discount rate for the Additional Liability be based on the contract rate at inception for income statement accretion purposes, but updated to a current contract rate for balance sheet measurement purposes, with the difference being reported in OCI, as

¹ Liability required under the guidance of AICPA *SOP 03-1 Accounting and Reporting for Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*

outlined in the Proposed ASU. This would ensure the balance sheet liability always reflects the present value of future expected cash flows using a more current, and arguably a more relevant, rate.

Profits followed by losses

The “profits-followed-by-losses” test currently required in ASC 944-60-25-9 is intended to require companies to record a liability in situations where a premium deficiency is not currently present in the aggregate for a line of business, but would otherwise be expected to occur at a future date, given a particular line of business being projected to exhibit a period of profits followed by one or more periods of losses. The Proposed ASU eliminates this “profits-followed-by-losses” test. However, the fact that the Additional Liability is based on total assessments versus total profits, we can envision situations where periods of profits followed by losses can still be present, despite the fact that assumptions would be updated at least annually (including an assessment for the need for an Additional Liability after the inception of the contract).

There could be other situations where the retrospectively accrued Additional Liability upon recognition of a “profits-followed-by-losses” event may be greater than the present value of the future losses. This is because the retrospective accrual would pick up not only the value of the eventual losses (even if it’s not material to the overall profitability of the contract) but also a retroactive revision to the profit recognition pattern. There would be distortions in the opposite direction when a “profits-followed-by-losses” situation is alleviated, resulting in the Additional Liability being retrospectively eliminated. This could result in a liability decrease greater than the change in the future profits, again because the change in liability would include an impact from retroactively changing the profit recognition pattern. This effect is demonstrated in the appendix to this letter labeled “Additional Liability.”

Also, because any cohort of nontraditional contracts could one day be in a “profits-followed-by-losses” situation, it would be necessary for companies to collect and retain all data since inception of every contract needed to calculate an Additional Liability even if the Additional Liability is not needed at inception. Since the information needed to calculate an Additional Liability is similar to that needed for non-traditional DAC amortization, this retroactive accrual would eliminate most of the practical benefits of simplifying the retrospective DAC amortization model currently applicable to non-traditional contracts.

We recommend that, before eliminating the “profits-followed-by-losses” test, the Board perform additional research and industry outreach to confirm that the proposed amendments for measuring the liability for future policy benefits and the Additional Liability, including updating assumptions at least annually, adequately address the “profits-followed-by-losses” issue without creating unintended consequences as described above. We do not believe that, as currently proposed, the requirement to annually assess for the need for an Additional Liability for non-traditional contracts would be an improvement over simply retaining the existing guidance (i.e., assessment at inception only) coupled with the current “profits-followed-by-losses” test.

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?

We agree that cash flows should be updated when assumptions change but we do not agree with retrospectively unlocking the net premium ratio. The best approach would be to prospectively unlock the net premium ratio when cash flow assumptions change.

The table below summarizes the advantages and disadvantages of each of these approaches to unlocking the net premium ratio:

	Retrospective unlocking of net premium ratio	Prospective unlocking of net premium ratio
Liability impacted by previous assumptions	No	Yes
Current period net income reports 100% of actual experience deviations	No. Partially offset, assuming net premium ratio less than 100%	Yes. No offset
Net income impact from changes in future assumptions	Partially offset, assuming net premium ratio less than 100%	Fully offset, assuming net premium ratio less than 100%
Calculation simplicity	Less	More
Calculation allows seriatim (policy by policy) liability calculations	No, requires cohorts	Yes
Ease of explaining results	Difficult – more volatility, but impact dependent on age of contracts and other factors	Simple – Actual vs. expected results are not offset; no impact from changes in future assumptions unless contract is onerous
Transparency of impact from assumption update	Less transparent	More transparent (via disclosures)
Transition	Difficult	Relatively simple
Consistency with IASB Insurance Standard	Inconsistent with prospective approach to be included in IFRS 17, <i>Insurance Contracts</i>	More in line with prospective approach to be included in IFRS 17, <i>Insurance Contracts</i>

The relative advantages of the prospective unlocking approach are outlined more fully below:

Liability Impacted by Previous Assumptions

There is one theoretical advantage to retrospectively unlocking the net premium ratio. Under retrospective unlocking, the liability only depends on actual historic experience and current best estimate assumptions for the future. Under prospective unlocking, the liability also depends on historic assumptions. While we acknowledge that this is a theoretical benefit of retrospective unlocking, we do not believe that it offsets the benefits of prospective unlocking described above.

Actual vs. Expected (Experience Adjustments)

Retrospective unlocking provides for a partial offset to the impact of actual experience differing from assumptions. We do not think that such offsets are appropriate. When actual experience emerges, it should be reflected in the liability and in net income immediately. Prospectively unlocking the net premium ratio accomplishes this.

Calculation Simplicity

Our experience with retrospective unlocking for DAC on universal-life type contracts has been that it is also unduly complex to calculate. Retrospective unlocking requires maintaining all historic cash flows and updating the liability for actual experience each period. These updates for actual experience are not always straightforward because aggregate impacts need to be allocated to the appropriate contract cohorts.

No Requirement for Cohorts

Retrospective unlocking also necessitates calculating the liability for cohorts of contracts rather than for individual contracts. This means maintaining historical experience for all contracts since inception in their original cohorts until the last policy in the cohort lapses, terminates or matures. Therefore, retrospective unlocking for actual experience would yield meaningful results only at the cohort level. That is because retrospective unlocking for actual termination experience only makes sense for cohorts. If the liability calculation were performed at an individual contract level, there would never be a unit remaining on which to retrospectively unlock the net premium ratio, since the individual contract that terminated would no longer be in force. Since many liabilities for future policy benefits for non-participating products are calculated today at an individual contract level, forcing cohort-level calculations could be a significant and costly change. By contrast, prospective unlocking can be performed on individual contracts because there is no offset to actual experience, and is relatively simple to calculate.

Ease of Explaining Results

Prospective unlocking would avoid large changes to financial statements when assumptions change, as long as the contract is not onerous (i.e., net premium ratio would exceed 100%). We view this as a benefit of prospective unlocking since assumption changes with respect to future cash flows often years or decades away may never materialize, and as long as we do not expect the contract to be onerous we do not think that large fluctuations in liability balances and net income from such changes resulting from actuarial judgment are particularly meaningful to users. Our basis for this presumption is that non-GAAP measures are often currently used to explain similar fluctuations resulting from retrospectively unlocking the amortization ratio for DAC on universal life-type contracts and we would expect similar measures to be needed if retrospective unlocking is used for the liability for future policy benefits for non-participating contracts. The impact of the assumption change on the present value of future cash flows should be included in the proposed enhancements to long-duration contract disclosures.

Under retrospective unlocking there would be potentially large impacts to liabilities and net income when assumptions change, but the impact would depend on a number of factors besides just the impact to the present value of projected future cash flows. Even for two situations in which the impact to the present value of projected future cash flows is identical, the financial statement impact under retrospective unlocking would differ due to factors such as the age of the contracts, the interest accretion rate used for

the contracts, and the net premium ratio before the change. In an extreme situation, such as a recently issued block of business, the impact of retrospective unlocking would be to show almost no financial statement impact. But for an older block of business the impact of an otherwise identical change would be much greater. Our experience with these disparate financial impacts for DAC associated with universal life-type contracts has been that users do not understand the impacts and we do not expect the situation to be any different if retrospective unlocking is used for the liability for future policy benefits.

Consistency with IASB Insurance Standard

Finally, prospective unlocking is also more in line with the approach to unlocking the contractual service margin that will be included in IFRS 17, *Insurance Contracts*, when issued in 2017.

Considerations for Additional Liability

We think that the same considerations apply to the Additional Liability. Although such liabilities are calculated by retrospectively unlocking the benefit ratio under current U.S. GAAP, this results in similar complexity in calculating and explaining results as it does for DAC on universal life-type contracts. Therefore, we would recommend using a prospective unlocking approach for the Additional Liability as well. There are some added benefits of using prospective unlocking for such liabilities:

1. Since there would be no need to update the benefit ratio for changes in actual experience, the possibility of negative assessments due to realized capital losses would be eliminated, and
2. Since there would be no need to update the benefit ratio for changes in actual experience, “shadow” liabilities would be eliminated.

A prospective approach to accruing the Additional Liability upon recognition of a “profits-followed-by-losses” situation may also be beneficial for addressing some of the problems discussion in Question 1. If the Additional Liability is accrued prospectively, i.e., starting at zero at the point when the “profits-followed-by-losses” situation is recognized, then the distortions from retroactively revising the profit emergence pattern would not occur. Also, such an approach would be practically much simpler to apply and would not undo the practical benefits of simplifying DAC amortization.

Currently the Additional Liability is defined as:

$$\text{Additional Liability} = \text{accumulated value of historical assessments} \times \text{benefit ratio} - \text{accumulated value of historic benefits}$$

We recommend that the Additional Liability be required, or at least permitted to be calculated, consistent with what we proposed for the calculation of liability for future policy benefits:

$$\text{Additional Liability} = \text{PV of projected benefits} - \text{PV of projected assessments} \times \text{benefit ratio}$$

As long as the benefit ratio is less than 100%, the two calculations result in an identical liability. But if the benefit ratio is capped at 100%, the two calculations have different results and only the prospective calculation directly calculates the correct liability. While the Proposed ASU notes that an additional liability should be accrued when the benefit ratio is capped, a prospective calculation would eliminate the

need for such an additional liability accrual. Even if a retrospective calculation is used, permitting a prospective liability calculation would help define what the additional liability accrual amount should be in the event the benefit ratio is capped.

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?*

Yes, we agree that cash flow assumptions should be updated on an annual basis, at the same time every year, unless actual experience or other evidence indicates that more frequent assumption updates are needed. The Board may want to consider having the final wording clarify that cash flow assumptions should be “reviewed and updated as necessary on an annual basis...” versus simply “updated”, to recognize the fact that after the annual review, certain assumptions, given their long term nature, may not need to change.

In addition, the Board should consider clarifying the requirement of “experience adjustments” under ASC944-40-35-6A(c). Actual experience should be reflected during the period in which the experience arises by updating the net premium ratio and the liability for future policy benefits. As indicated in the letter to the FASB dated September 15, 2016 from the American Academy of Actuaries², waiting to reflect the actual experience during the annual assumption review would cause financial results being distorted from the “catch up” even if the actual experience specific to the period agrees with expected experience. Furthermore, it would lead to diversity in practice in interim financial reporting as companies choose to update cash flow projections each period versus once a year during assumption review.

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?*

MetLife supports the use of objective, market observable inputs to discount cash flows for non-participating liabilities as a means of providing a more current value estimate to investors and other users of U.S. GAAP financial statements. Moreover, we believe high-quality fixed-income instrument yields can provide a basis for such a discount rate. However, to the extent “high-quality fixed-income” is synonymous with an index comprised of “AA rated” companies, we disagree and instead recommend use of an index comprised of “A rated” bonds. Possible wording to describe such an index would be a “representative investment-grade fixed-income investment yield” or a “representative market-consistent fixed-income investment yield.”

The support for our recommendation of an index of “A rated” securities is threefold. Specifically, spreads observed from an “A rated” index of bonds:

- Better align with spreads observed in insurer new business pricing for fixed rate liabilities, which, in competitive markets, reflects how an investor would deploy capital to liabilities with non-participating, fixed-rate characteristics
- Better represent the allocation of insurer investments across the credit spectrum – which are designed to match the characteristics of insurance liabilities

² http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=INSLD-UNS

- Align with the majority of insurer ratings, which establish the environment for insurance liability prices

We acknowledge this proposal suggests a different discount rate for fixed-rate insurance liabilities than for pension liabilities; however, we believe the substantial differences in total funding requirements is a critical characteristic of these classes of liabilities that warrants different discount rates.³

The remainder of this response elaborates each of the points outlined above regarding using an index of “A rated” securities for discounting insurance contract liabilities.

Consistency with Insurer Pricing

MetLife and many of its life insurance peers price fixed rate liabilities predominantly based on their view of the risk-adjusted return of the business, a significant driver of which is returns on assets available to match the liability. The following (i) elaborates on how insurers derive risk-adjusted return from investment allocations and (ii) provides an empirical example of how the resultant “liability spreads” observed in the pricing of liabilities in competitive markets relate to market observable spreads. Both points suggest use of a rate derived from investments with a credit quality below an index of “AA rated” companies.

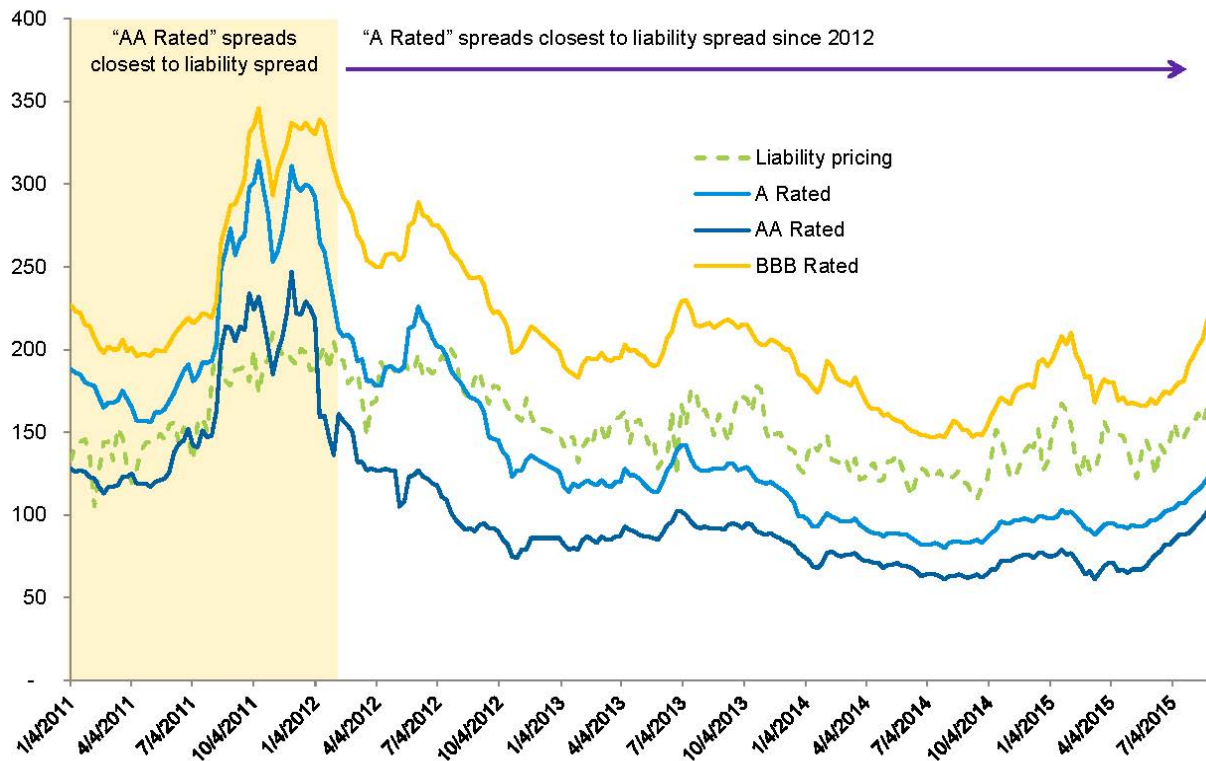
In general, insurers price products to achieve a desired return, including a cost of capital, considering liability payments, expenses, taxes, asset returns and capital required to support the risks of the business. Competitive markets tend to attract a narrower range of prices, implying that companies apply similar assumptions in pricing and which provide an observable market discount rate for the liability. This so-called “liability spread” is measured consistently with assets spreads, expressed as the yield of the liability over risk free rates as described below:

$$\text{Liability Spread} = \text{Liability yield} - \text{Risk-free rate (duration matched)}$$

MetLife compared corresponding asset spreads with the liability spread for single premium 10-year term certain payout annuities over the past five years.⁴ The results of the analysis are shown in the following diagram:

³ Pension funding requirements are measured solely based on discounted liability cash flows; by contrast, insurers discount liability cash flows and hold additional, costly risk capital. This difference in cost-of-capital justifies a difference in the discount rate.

⁴ Price quotes are obtained from the most competitive six prices offered at each observation date. Corporate bond spreads are the average of the 3-5 and 5-7 year maturity bonds of specified ratings obtained from Bank of America Merrill Lynch. Liability spread reflects a 4% gross distribution expense, standard for the industry. Although technically not insurance contracts given the absence of life contingent payments, term certain annuities provide an optimal comparison of liability and asset spreads because (i) insurers price these liabilities in a manner consistent with life contingent payout annuities and (ii) the certainty of the ‘term certain’ cash flows eliminates any variation in unobservable mortality assumptions that may differ by company.



The analysis supports the following conclusions:

- The credit quality index that best matches the liability spread varies over time – suggesting the liability spread is sensitive to the spreads associated with the broader set of investments within the typical insurer investment allocation
- The single credit quality index that best matches the liability since 2012 – a period we think is representative of the longer-term – consistently has been the “A Rated” index
- The spread for the “AA Rated” index has been below the liability spread for virtually all observations since 2012 – and for many periods substantially below the liability spread

The latter observation indicates that, had the “AA rated” index been in use, investors would have perceived insurers new business activity as routinely value destroying. We think this is a false and damaging signal for an accounting system to send to shareholders.

Anticipating that the Board wishes to select a single index of bonds upon which to derive the discount rate, we think these collective observations provide a clear basis to select the “A rated” index to discount non-participating, fixed-rate liabilities.

Better Reflects Insurer Investment Allocations

An appropriate discount rate for non-participating contracts would be derived from a replicating portfolio of assets that matches the liability characteristics. The yield on the replicating portfolio assets would need to be reduced by expected default losses as well as a charge for the risk of unexpected defaults. We agree with the Board that the replicating portfolio of assets for non-participating liabilities, and therefore the discount rate, should not be based on an individual company’s investments. However, the discount rate should be based on the manner in which the industry in aggregate prices non-participating life insurance contracts. Insurers invest to match the liability characteristics of long-duration non-participating

contracts price insurance contracts every day on that basis. The selling prices of life insurance contracts reflect the characteristics of the liabilities and therefore, the aggregate fixed-income portfolio of the insurance industry is a useful starting point as to determine the appropriate illiquidity premium and discount rate for non-participating contracts. Data from the ACLI indicates that the insurance industry invests in fixed-income instruments that are on average below AA in quality.

After deducting expected default losses and a charge for unexpected defaults, this indicates that the illiquidity premium for non-participating contracts for the insurance industry as a whole is closer to an A spread than a AA spread.

Aligns with Insurance Company Ratings

Below is a table showing the percentages of North American companies by Moody's claims paying rating class. A majority of life insurance companies have "single A" claims paying ratings, with some companies higher and some lower. This observation corroborates the prior analyses that life insurance contracts are priced consistent with a "single A" rating and should use a corresponding "A rated" discount rate.

Moody's Rating	Ratio by Rating	Ratio by Category
Aaa	3%	3%
Aa1	4%	23%
Aa2	3%	
Aa3	15%	
A1	24%	58%
A2	25%	
A3	9%	
Baa1	3%	15%
Baa2	8%	
Baa3	5%	
Ba2	1%	2%
Ba3	1%	
	100%	100%

Insurance Contracts Liabilities Should Not Necessarily Use the Same Discount Rate as Pension Liabilities

We understand the tentative decision to reference a high-quality fixed-income instrument yield within the targeted improvements is based in part on use of a precedent in current U.S. GAAP. A "high-quality" yield is referenced elsewhere in the accounting standards, including in pension accounting. Since the SEC has interpreted it to be a AA rate for pension accounting, many in the life insurance industry are concerned that the Board's intent may be to use a AA rate for US denominated insurance contracts.

There are important differences between pensions and insurance that justify why a AA rate is not appropriate for discounting non-participating insurance liabilities despite its use to discount pension liabilities. Insurance company liabilities are governed by a strong regulatory framework including risk management, full funding of liabilities, capital requirements and controls on investments held. Consequently, the regulatory framework requires insurers to hold assets in excess of the best-estimate liability value. Pension accounting and funding rules do not incorporate the concept of risk capital and

consequently need a more conservative discount rate in order to produce comparable total funding requirements as insurers who do hold capital beyond the best-estimate liability.

Field Testing Results

We field tested the tentative decisions and we are concerned by the results showing the impact to OCI and to total comprehensive income based on a AA discount rate rather than an A discount rate. These results indicate that, at least in times of market dislocation such as was the case in 2008, the AA spread does not provide an adequate illiquidity premium for non-participating contracts. In 2008 when the financial markets became distorted and illiquid, the spread between A and AA rates increased substantially. In our field testing sensitivity test results this generated a large difference in OCI between discounting liabilities using an A spread versus a AA spread. We are concerned that in such markets this impact could lead to a large artificial decrease in equity under U.S. GAAP, or even negative equity that would be a false signal to both investors and regulators who may use U.S. GAAP financial statements as a measure of insurance company solvency. When the financial markets normalized in 2009, the spread between A-rated and AA-rated securities mostly reversed.

During times of market dislocation, requiring the use of a AA discount rate could have a procyclical effect. Faced with non-economic reductions in their reported U.S. GAAP equity and the potential resultant loss of market confidence in their stability, insurers may be artificially forced to reduce certain long-term investments, including infrastructure, that could unnecessarily have a negative impact on economic growth.

Tenors Beyond the Observable Yield Curve

We agree with paragraph 944-4-55-13E of the tentative decision that permits an insurer to make an estimate consistent with a level 3 fair value measurement for points on the yield curve where there is limited or no observable market data. This addresses a significant concern with the 2013 FASB Exposure Draft on Proposed Accounting Standards Update - *Insurance Contracts (Topic 834)*.

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?*

We agree that the effect of the change in discount rate should be recorded in OCI immediately. This accounting would provide financial statement users with useful information regarding how changes in discount rates impact long-duration insurance liabilities along with the underlying investments, which are primarily fixed maturity securities accounted for as available-for-sale, with changes in fair value (significantly driven by interest rate changes) also reported in OCI.

While we agree with this tentative decision, and notwithstanding our recommendation for a prospective approach as outlined in our response to Question 2, we believe that the proposed guidance in ASC 944-40-35-6(a) needs to be modified to appropriately describe how the amount to be reported in net income (versus OCI) is to be calculated. As it reads currently, the term “carrying amount” could be interpreted as the amount previously reported on the balance sheet, which would not be the appropriate amount to use for purposes of determining net income. We recommend that the wording in this subparagraph be clarified to indicate that the updated liability for future policy benefits, using the discount rate at inception, should be compared to the previously calculated liability for future policy benefits, also using

the discount rate at inception, to determine the cumulative catch-up adjustment to be recognized in current period benefit expense.

A similar modification is needed to the proposed guidance in ASC 944-605-35-1B(c) covering the impact of interest rate changes on deferred profit liabilities.

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?*

We agree that discount rate assumptions should be updated at each reporting date for contracts other than participating contracts, given that the carrying value of underlying invested assets reported at fair value through OCI would also be impacted by interest rate changes at each reporting date.

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?*

We generally agree that participating insurance contracts should be included in the scope of the targeted improvements. However, we have concerns about applying the specific model proposed to participating contracts. In our opinion, the model as developed for non-participating contracts is not suited to participating contracts with adjustable crediting rates responding to interest rate changes. Please refer to our comments in Questions 8 - 11 for further discussion.

Additionally, we would suggest permitting a simpler alternative model for closed block contracts resulting from a demutualization. This can be achieved in one of the following two approaches.

Fair Value Option Approach - This approach would permit a fair value option (“FVO”) election for closed block liabilities upon transition. The FVO election should also be available to insurers upon any future demutualization. The FVO election for closed block liabilities would simplify the accounting model and alleviate insurers from having to maintain history on older closed block businesses, thus achieving some level of cost reductions. Many insurers have closed block businesses containing contracts issued over fifty years ago.

As a practical expedient, this approach could also be made applicable for blocks of business that insurers had discontinued selling many years ago.

Quasi-Separate Account Approach - The other approach would be specific to demutualization closed blocks. This approach would explicitly take into account the fact that the insurer’s obligation in demutualization closed blocks is to pay the policyholder the value and the returns of the closed block assets while covering any guaranteed benefits within the contracts. Since this approach explicitly takes into account the specific nature of demutualization closed blocks, it would provide more meaningful, reliable and representationally faithful information, despite its simplicity.

Under our proposed model for this approach, there would be two or three components. The first two components are essential to achieving a representationally faithful model. The last is optional depending on whether the Board considers it important:

1. A base liability equal to the carrying value of the closed block assets. This recognizes the insurer's obligation to pay the closed block policyholders the value of the closed block assets and any returns on those assets, similar to a separate account.
2. A market risk benefit-type liability measuring any contractual guarantees that are not expected to be able to be funded from the closed block assets. This liability, which could have a value of zero or close to zero under most circumstances, accounts for the fact that the insurer would be obligated to pay for any contractual death or surrender benefits even if the closed block assets are insufficient to cover such liabilities.

Similar to the proposed measurement for market risk benefits, this portion of the liability could be carried at fair value. If calculated at fair value, an option derivative valuation methodology consistent with that for the market risk benefits could be used. A non-option derivative valuation methodology would not be appropriate as it requires certain fee attribution, which would not be applicable to the closed block businesses.

Alternatively, the Board could consider an Additional Liability similar to that for non-traditional contracts, whereby the insurer would have to review for the existence of a deficiency. If a deficiency exists, an Additional Liability would be accrued similarly to the Additional Liability for non-traditional contracts to fund the deficiency amount. If this methodology is used, premiums could be used in the benefit ratio calculation in lieu of expected assessments and the expected accrued closed block asset balances could be used in lieu of expected accrued account balances. The Board could decide to use either the discount rate that is analogous to the contract rate and is locked in at the demutualization date (or at the transition date as a practical expedient) or, in lieu of the contract rate, use the current market discount rate consistent with that of the non-participating contract. Note that in accordance with our response to Question 2 regarding additional liabilities, this additional liability would only fund the amount of any expected deficiency, not all the death benefits in the contract.

Another alternative would be to simply leave existing "profits-followed-by-losses" testing currently required under ASC 944-60-25-9.

3. (optional) Under this proposal, when an insurer demutualizes, there would be a change to the liability value as the liabilities and DAC calculated using the standard participating contracts model are replaced by our proposed liability. In our view this is appropriate because the nature of the obligation between the insurer and policyholder changes as a result of demutualization. But if the Board disagrees, an accrual can be made for the difference between the benefit liability, DAC, policyholder dividend obligation and any other asset or liability backing the contract immediately before demutualization or transition, and the sum of items #1, #2 and, if used, #3

above. This accrual can be amortized over time in accordance with the Board's proposed approach for amortizing DAC.

If the Board does not agree to our proposed alternative model as discussed above and decides to move forward with applying the non-participating contract model to demutualization closed block liabilities, an amendment to ASC 220 is needed. ASC 220-10-45-10A seems to permit a "shadow" adjustment to the policyholder dividend obligation to offset the impact of unrealized capital gains and losses on closed block assets. However, ASC 220 does not seem to explicitly permit a shadow adjustment to the policyholder dividend obligation to offset the impact of changes in the liability for future policyholder benefits resulting from changes in the discount rate assumptions. Interest rate changes generate both unrealized gains and losses on the closed block assets and amounts reported in OCI for the changes in the closed block liabilities. Either both need to be offset by a shadow adjustment to the policyholder dividend obligation or else neither should be offset. Offsetting one but not the other would create non-economic volatility in OCI.

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?

As discussed in our response to Question 2, we do not agree with retrospective unlocking. However, regardless of the method of unlocking the net premium ratio, there is an issue specific to participating contracts that needs to be addressed.

Unlike non-participating contracts, certain participating contracts have cash flows that change as a result of interest rate changes. When interest rates change, projected dividend crediting rates change in response, which change projected cash flows. Additionally, when interest rates change, the liability discount rates will also change in response to changes in interest rates. In order to avoid accounting mismatches, the interest-related cash flow changes need to be consistent with the related changes in discount rates.

As we understand the Proposed ASU:

1. The full impact of the change in discount rates on the present value of future cash flows will impact the liability balance, with the impact reported in OCI, and
2. The impact of the change in projected cash flows resulting from the change in projected dividend crediting rates would be partially offset by retrospectively unlocking the net premium ratio, with the impact reported in net income.

This differential accounting treatment between changes in discount rates and changes in interest-sensitive cash flows means that even if there is no change to the contract's underlying profits, because the dividend crediting rate change exactly offsets the change in discount rates economically, there would still be an impact to the financial statements. For example, assume:

Change in present value of future cash flows resulting from discount rate change +\$1,000
Change in present value of future cash flows resulting from crediting rate change -\$1,000

*Offset to PV of future cash flows resulting from
retrospectively unlocking net premium ratio* 60%

Although economically there should be no impact to the liability on the balance sheet or to net income or to OCI, what would actually be reported is:

*Change in balance sheet liability = $1000 - 1000 \times (100\% - 60\%) = \600
OCI impact = $-\$1000$
Net income impact = $+\$400$*

Neither of these accounting results reflects the underlying economics.

We can see two possible solutions to this issue.

1. Do not unlock the net premium ratio for change in projected cash flows resulting from changes in interest rates and report the impact of the change in interest sensitive cash flows in OCI. We think this is the simplest and most straightforward approach. It is also generally consistent with the approach that the IASB took to account for insurance contracts with participating features. Under this approach, the net premium ratio would not be unlocked for changes in discount rates or for changes in interest sensitive cash flows. All interest rate change impacts – from both discount rates and interest sensitive cash flows – would be reported in OCI. This would avoid accounting mismatches and produce an OCI/net income split consistent with the underlying economics.
2. Unlock the net premium ratio for changes in interest sensitive cash flows but use revised interest accretion rates consistent with the projected crediting rate pattern to discount all cash flows when determining the revised net premium ratio. This is the approach suggested in Northwest Mutual’s comment letter⁵ to the FASB dated June 6, 2016. Under this approach, the impact to the OCI/net income split is addressed by the fact that the net premium ratio is unlocked using revised interest accretion rates that are consistent with the revised dividend crediting rates.

This approach is only feasible if the Board chooses to update the interest accretion rates for participating contracts such that the interest accretion rates are consistent with the pattern for projected dividend crediting rates, i.e., the “level spread approach.” This level spread approach is one of the approaches that could be used to fix the issue of locking in the interest accretion rate for participating contracts, but it is not the only approach that could be used to address that issue. See our response to Question 11 for more on this topic.

The Board should consider clarifying the requirement under ASC 944-50-25-2 and ASC 944-50-30-2 given, under the Proposed ASU, the expected policyholder dividends would be explicitly included in determining the liability for policy benefits.

⁵ http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=INSLD-UNS

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?

Yes, we generally agree that cash flow assumptions should be updated on an annual basis, at the same time every year, unless actual experience or other evidence indicates that more frequent assumption updates are needed. Please refer to our response to Question 3 for clarification needed to the Proposed ASU.

However, as discussed in our response to Question 8, there is a special consideration for participating contracts. Participating contract cash flow projections may change due to anticipated dividend crediting rate adjustments when there are movements in market interest rates. These cash flow changes need to be treated consistently with changes in discount rates in order to avoid accounting mismatches. Therefore, while most changes in cash flow assumptions can be generally updated on an annual basis, consistent with updates to discount rates, changes in dividend crediting rates need to be updated each reporting period. Doing otherwise would be equivalent to valuing floating rate debt instruments by updating the discount rate each reporting period but updating the interest sensitive cash flows only annually.

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?

We do not agree. Our concern with a “high-quality fixed-income instrument yield” for non-participating contracts is discussed in our response to Question 4. But we have more fundamental concerns with using such a rate for participating contracts.

For non-participating contracts, the insurance contract cash flows are independent of any asset returns. A discount rate that is independent of the returns on the assets backing the contracts can be appropriate provided that the discount rate provides for an adequate illiquidity premium. However, for participating contracts that follow the contribution principle, as defined in ASC 944-20-15-3, the liability cash flows have significant dependence on the assets backing the insurance contracts. As a result, a theoretically correct discount rate needs to reflect the expected returns on the assets backing the participating contracts.

Per ASC 944-40-30-15A of the Proposed ASU, “policyholder dividend assumptions used in estimating the liability for future policy benefits shall be based on estimates of dividends expected to be paid to policyholders.” The best estimate of dividends expected to be paid to policyholders would be based on the assumption that the policy would credit interest commensurate with the returns expected on the assets backing the participating contracts. The best estimate of dividends would thus not be “de-risked” estimates, since they would incorporate a spread over risk free rates that the insurer expects to be able to earn on those assets.

For example, assume the following for a single premium participating contract with minimal expenses or mortality risk and no profit charges that endows after five years:

Initial premium	\$1,000
Expected yield on assets backing the liability (after expected default losses)	6%
High-quality fixed-income instrument yield	5%

If dividends are paid annually, we would expect dividends to be equal to 6% of the policyholder funds each year. That would result in annual cash flows of:

Year	1	2	3	4	5
Cash flow	\$60	\$60	\$60	\$60	\$1,060

If these cash flows are discounted at the expected asset yield of 6%, the present value of future cash flows at inception is equal to \$1,000. This is the theoretically correct result because the initial liability would exactly equal the initial premium with a net premium ratio of 100%. This is consistent with the fact that the contract has zero profits.

But if these cash flows were discounted at the high-quality fixed-income instrument yield of 5%, the present value of future cash flows at inception would be \$1,043. This would imply a loss at inception of the contract. However, this is not an economic loss. It merely represents that we are discounting the cash flows at a rate inconsistent with the characteristics of the liability.

Similarly, it would not be correct to split the cash flows between dividend cash flows discounted at the asset-based rate and fixed cash flows discounted at the high-quality fixed-income instrument yield. The 6% asset-based rate is credited to all the funds in the contract, not just to the dividend cash flows. The maturity value – and in more realistic examples the death and surrender payments – are analogous to principal repayments on floating rate bond or mortgage instruments. It would not be correct to value a floating rate instrument by discounting interest cash flows at the floating rate with discounting principal repayment cash flows at some other fixed rate. It would be similarly incorrect to discount dividend cash flows of a participating contract at an asset-based rate with the death and maturity benefit cash flows at a different rate. As can be seen in this example, if the annual dividend payments were discounted at the asset-based rate but the \$1,000 maturity benefit was discounted at the high-quality fixed-income instrument yield, the present value at inception would be \$1,036. Again, this would represent a loss at inception that is not consistent with the economics of the contract.

If the Board objects to discounting participating contract cash flows at a rate that reflects asset returns, there is an alternative approach that can be used to resolve this issue. Instead of calculating the liability for future policy benefit using the company’s best estimate of future dividends, the liability could be based on “hypothetical” dividends that are consistent with an assumption that the assets backing the liability would earn a yield consistent with the discount rate. This would provide the necessary internal consistency between the interest credited to the contract and the discount rate. That approach would effectively “de-risk” the cash flows, such that a discount rate divorced from assumed asset returns would be appropriate. In the example above, this would mean that the liability would be calculated assuming annual dividends of \$50 per year instead of the best estimate of \$60 per year. Calculating the present value of future cash flows at inception of the contract assuming annual dividends of \$50 and discounting at 5%, would produce the appropriate initial liability of \$1,000.

Although we believe there are two main approaches the Board could use to resolve the inconsistency between dividend crediting rates and discount rates for participating contracts, our preference is the first approach. Calculating hypothetical dividends that are inconsistent with actual best estimate dividend expectations would add substantial complexity to the calculation. Dividend scales are often based on a number of factors that interact to some extent, so revising the expected dividends for a different crediting rate is often not as simple as merely dropping a different crediting rate into the liability valuation. Given that both approaches produce theoretically appropriate results, it would be much simpler to discount cash flows that represent the insurer's best estimate of dividends by an asset-based discount rate.

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?

We agree with the concept that the effect of the change in discount rates should be recorded in OCI immediately for participating contracts. This accounting would provide financial statement users with useful information regarding how changes in discount rates impact long-duration insurance liabilities along with the underlying investments, which are primarily fixed maturity securities accounted for as available for sale with changes in fair value (driven by interest rate changes) also reported in OCI. However, as more fully explained below, we do not believe that the proposed methodology appropriately captures the portion of the change in liability attributable to discount rates in OCI versus net income for participating contracts.

The proposed methodology for calculating the impact of a change in discount rates to be reflected in OCI as opposed to net income for participating contracts is based on an interest accretion rate that is locked in at contract inception. While this methodology is appropriate for non-participating contracts, given the implicit crediting rate is effectively fixed for the life of these contracts, it is not appropriate for participating contracts whose crediting rate is, by definition, not fixed.

In general, for a participating contract, if interest rates decline, the dividend crediting rate would be expected to decline without a significant net economic impact to the insurer. The proposed methodology would discount these lower projected dividend cash flows at a locked-in interest accretion rate for determining net income. This would cause an immediate gain in net income even though the contract is no more or less profitable economically than it was before the interest rate decline, resulting in this gain eventually reversing through net income over time in the future. While the balance sheet liability would appropriately discount the lower projected cash flows at a lower discount rate, the allocation between net income and OCI would not accurately reflect the underlying economics. If interest rates increased, the proposed methodology would result in an immediate loss in net income, just to be reversed over time, not appropriately capturing the underlying economics.

We have identified two potential solutions to address the concern outlined above:

1. *Level Spread Approach* (our preference) – This approach would require the use of interest accretion rates that are not locked in, specifically a curve of rates that adjust in parallel to changes in projected dividend crediting rates. This approach solves for a “level spread” relative to projected dividend crediting rates in each future period such that the net effect of the change in crediting rates and the change in interest accretion rate curve does not impact net income. This

approach is similar to the methodology put forth for participating contracts in the 2013 Proposed Accounting Standards Update – *Insurance Contracts (Topic 834)*, to which our comment letter at the time had a similar recommendation.

2. *Hypothetical Dividend Scale Approach* - Under this approach, the interest accretion rate can be locked in as described in the Proposed ASU, but then the projected dividends used in the liability calculated to determine net income would also be based on the interest rates locked in from contract inception. This would effectively result in two dividend scales being used at each reporting date: (a) a dividend scale based on current interest rates that would be used to calculate the balance sheet liability and (b) a dividend scale based on the locked-in dividend crediting rates from contract inception (i.e. the hypothetical dividend scale) that would be used to determine net income. Under this approach, changes in dividend crediting rates since inception of the contract would not be reported in net income. Net income would be reported based on dividend crediting rates that were in effect at contract inception.

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?

Assuming that the concerns we expressed in our response to Question 9 are addressed, we agree that discount rate assumptions should be updated at each reporting date for participating contracts since the carrying value of underlying invested assets reported at fair value through OCI would also be impacted by interest rate changes at each reporting date.

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?

Yes, we generally agree with the scope. The criteria in ASC 944-40-25-25C would capture variable annuities, which would eliminate complexities in applying the current guidance in terms of identifying the appropriate accounting model. We agree that such contracts exposing an insurer to other-than-nominal capital market risks should be included in the scope of market risk benefits. These changes would reduce the significant diversity in practice in accounting for these products.

The Board could consider retaining current guidance for death benefit guarantees that would otherwise be considered market risk benefits within the scope of ASC 944-40-25-25C. Death benefit guarantees are more similar to life insurance than the other market risk benefits being contemplated in the Proposed ASU since the timing of the benefit payment is directly linked to an insurable event. Other market risk benefits (generally referred to as living benefits) are available to contract holders at their election, subject to waiting periods, and their associated fair values are significantly impacted by contract holder behavior. Once a living benefit is “in-the-money”, there is a high likelihood it will be utilized by the contract holder at some point in the future.

Conversely, over a reasonable time horizon, death of the contract holder is generally unlikely. Thus, the triggering event for receiving the death benefit provides substantial mitigation against an in-the-money death benefit being paid, giving insurers an opportunity for markets to recover. Additionally, there may

be further mitigation as contract holders could have incentives to take cash withdrawals from the contract that generally reduce the value of an in-the-money death 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?*

We generally agree that market risk benefits should be measured at fair value, with fair value changes attributable to changes in instrument-specific credit risk recognized in OCI. This measurement attribute for market risk benefits would be an improvement as it simplifies current guidance (one model versus multiple models), more closely aligns the accounting for market risk benefits with any associated hedging activities (and equity securities), and eliminates non-economic volatility related to changes in “own credit”.

We noted that ASC 944-40-35-8B would require entities to recycle amounts in accumulated other comprehensive income (AOCI) to earnings upon derecognition of a market risk benefit. This treatment is consistent with the newly issued guidance for financial liabilities where the fair value option has been elected and the amounts recycled to earnings related to instrument-specific credit risk for fair value option liabilities have actually been monetized. However, we do not believe this would be appropriate for certain guarantees, such as guaranteed income benefits that are annuitized, as the amounts recycled to earnings related to instrument-specific credit would not have been monetized upon annuitization. In this case, the liability would merely be re-characterized from a market risk benefit to a liability for future policy benefits. As the inherent risk of non-performance is identical both before and after annuitization, it may not be appropriate to recognize the full effect of the non-performance risk in earnings solely due to annuitization as if it had been monetized.

Please see our response to Question 21 with respect to the transition methods for market risk benefits.

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?*

We agree that the proposed amendment should not include the investment contract acquisition costs currently amortized using the interest method in Subtopic 310-20, *Receivables—Nonrefundable Fees and Other Costs*. This approach is consistent with the accounting for non-insurance financial institutions.

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?*

In general, we agree with the proposed amendment to simplify the amortization of DAC. The simplified method would eliminate the need for retrospective unlocking, which is complex and difficult to understand.

However, in the absence of enforceable information, the Board should allow policy counts or other alternative methods (such as account value or deposit amount for investment contracts that do not qualify for interest method amortization) as a basis for amortization before defaulting to a straight-line method. The policy

count approach would be helpful when the “inforce” information is not available or unclear, such as variable annuity contracts with death benefits.

The Board should clarify whether it was its intention for insurers to amortize other items, such as intangible assets arising in a business combination (commonly referred to as value of business acquired or “VOBA”) and cost of reinsurance, in the same manner as DAC in the Proposed ASU. Current U.S. GAAP does not specify such items are to be amortized in the same manner as DAC, but in practice, many companies follow the same amortization method(s) as DAC. We suggest the Board provide clarification that allows and/or requires these items be amortized the same way as specified for DAC in the Proposed ASU. Furthermore, we believe that impairment testing is still necessary for DAC. Please see our response to Question 17.

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?*

We believe that DAC associated with long-duration contracts should be subject to an impairment test for the following reasons:

- Consistent with existing guidance that has been in place for decades, DAC (whether for short or long-duration contracts) meet the definition of an asset in FASB Concepts Statement No. 6 (CON 6) because the acquired contracts to which they relate provide future economic benefits in the form of expected net cash inflows. ASU 2010-26 provided additional guidance on what types of acquisition costs meet the definition of asset, and are thus deferrable, versus those that should be expensed as incurred.
- DAC for short-duration contracts in ASC 944 have always been, and continue to be, subject to an impairment test (via a premium deficiency test). The associated future economic benefits for short-duration contracts are inherently subject to less uncertainty, as they are generally realized over a relatively short period of time, often one year or less. The associated future economic benefits for long-duration contracts are inherently more uncertain, as they are generally realized over a relatively long period of time, often many years or even decades.
- We believe the basis for concluding that no impairment test is required for DAC relating to long-duration contracts by making an analogy to debt issuance costs is not appropriate because:
 - CON 6 (paragraph 237) specifically acknowledges that debt issuance costs do not meet the definition of an asset precisely because they provide no future economic benefit
 - ASU 2015-15 acknowledges that only debt issuance costs associated with line-of-credit arrangements are deferrable as assets
 - It is not appropriate to analogize DAC, which meets the definition of an asset, to either debt issuance costs that do not meet the definition of an asset or to debt issuance costs associated with line-of-credit arrangements.
- The current premium deficiency (a.k.a. loss recognition) test for long-duration contracts, which the Proposed ASU eliminates, jointly tests for the recoverability of DAC as well as the adequacy of insurance liability. We acknowledge that the proposed annual unlocking of assumptions addresses the liability adequacy aspect of the current premium deficiency test, but it does not address the DAC recoverability aspect.
 - It is possible for a portfolio of long-duration contracts that were expected to provide future economic benefits at inception to at some point in the future no longer be able to provide enough future economic benefits to support full recovery of the associated DAC even if reserves reflect updated best estimate assumptions

- Without an impairment test for DAC, there could conceivably be DAC recorded as an asset that does not meet the definition of an asset, in whole or in part, which we do not believe is an appropriate accounting result

For simplicity, we recommend that a DAC impairment test be developed similar to the current loss recognition testing model and at the same level of aggregation as described in ASC 944-30-25-1B (which the Proposed ASU is not amending). For traditional and limited payment contracts the test would effectively compare the present value of future profits (i.e., implicit margin) inherent in the group of long-duration contracts to the DAC balance associated with that group of contracts in conjunction with the annual assumption update process. To the extent there is a shortfall, the DAC would be written down to effectively be capped at that amount. A similar process would apply to universal-life and investment-type contracts, but the present value of future profits would need to be able to incorporate the Additional Liability and unearned revenue liability.

Consistent with current practice, VOBA and sales inducements should be included in the impairment testing outlined above, instead of following varying guidance; for example, ASC 350-30 for VOBA.

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?*

We generally agree with the presentation requirements to record the change in the liability for future policy benefits attributable to the discount rate as discussed further in our response to Question 5 and 11. In addition, we generally agree that the change in fair value of market risk benefits associated with instrument-specific credit risk be reported in OCI. We do not object to reporting the carrying value of market risk benefits separately in the balance sheet and statement of comprehensive income.

We generally agree that enhanced disclosures of information about long-duration contracts would provide decision-useful information; however the proposed disclosures are voluminous and a significant amount of information for financial statement users to understand and utilize effectively. Accordingly, we have several suggestions related to frequency and content that we believe would make the disclosures more decision-useful, balancing cost-benefit considerations.

Frequency – There are certain disclosures of qualitative information, such as descriptions of acquisition costs capitalized and the types of products housed in separate accounts that by their nature will not change significantly from period to period. We urge the Board to consider requiring these disclosures annually, rather than every quarter, unless a significant change occurs during an interim period. The following sections contain disclosures of qualitative information not expected to change significantly from quarter to quarter that could be provided annually: ASC 944-30-50-2A c., ASC 944-30-50-3 a., ASC 944-40-50-6 b.5., ASC 944-40-50-7A e., ASC 944-40-50-7B b.2. and d., ASC 944-80-50-1 a. and b.

Policyholder Account Balance and Market Risk Benefit Disclosures – Both rollforward disclosures require disclosure of the “guaranteed benefit amounts” in excess of the account value. This term is not defined but it appears, based on the illustrations and examples that the intent is to capture the net amount at risk. Therefore, we would suggest that the Board clarify the disclosure to require the net amount at risk. Also, the disclosures for policyholder account balances in ASC 944-40-50-7A require disclosures around

hedging activity undertaken to manage capital market risk. This disclosure could be considered redundant since any product features with capital markets risk would already be covered in the market risk disclosures of ASC 944-40-50-7B.

Market Risk Benefit and Fair Value Disclosures – The proposed disclosures around market risk benefits would contain much of the same information required under the fair value disclosures of Topic 815, given these are generally Level 3 under the fair value hierarchy. Therefore, we suggest scoping market risk benefits out of the Topic 815 disclosures.

Disclosures of Undiscounted Premiums and Benefits - ASC 944-40-50-6 in the Proposed ASU requires disclosure of the undiscounted ending balance for both expected future net premiums and expected future benefits. Net premiums are an actuarially-derived construct used to determine the liability that is required to be accrued for future policyholder benefits; accordingly the undiscounted cumulative balance would provide less meaningful information than gross premiums as it is not a contractual cash flow. Therefore, we suggest modifying the disclosure to require expected future gross premiums instead of future net premiums, which when compared to expected future benefits would provide more decision-useful information about expected future cash flows on insurance contracts.

Rollforward Disclosures - We do not believe disclosure of weighted average of assumptions used to develop liabilities would provide meaningful information. Assumptions could vary significantly depending on the type of products, product features, age of the inforce and other factors such as underwriting and sales practices. Comparing weighted averages across companies or even within the same company does not necessarily provide any insight to the underlying assumptions, and could even be misleading. For example, a better average mortality of one company as compared to another company does not necessarily mean one company is more conservative than the other, or the underlying product is more profitable. Both companies could, in fact, be appropriately reflecting their product designs and experiences.

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.*

The Board should clarify whether a rollforward for the Additional Liability is required under ASC 944-40-50-6 given many of the subsections, including rollforward line items referenced in ASC 944-40-55-13I and Example 3 in ASC 944-40-55-29E, are not applicable to the Additional Liability.

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?*

MetLife requests an effective date such that the implementation period is no less than four years, given the extensive changes associated with the proposed targeted improvements. Recently issued standards have allowed for over three years for implementation of less pervasive changes. For example, both ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326)* and ASU No. 2016-11—*Revenue Recognition (Topic 605)* provided at least three and a half years for implementation from issuance of the

final standard. It is important to have sufficient time to implement targeted improvements consistent with the time allowed for the implementation of other standards. If the Board accepts our recommendations on prospective unlocking and simplifying transition, implementation could be completed as much as a year earlier. The Board may want to consider an effective date of at least one year later for non-public entities. In addition, early adoption should not be allowed due to the complexity of the new proposals and issues regarding comparability.

There are several key drivers affecting the timing of implementation. Insurance companies are facing the simultaneous or staggered implementation of multiple new U.S. GAAP accounting standards, statutory accounting and regulatory changes, and additional regulation with accompanying reporting requirements from state, federal, and multiple international regulators. Many companies with significant operations outside the U.S. could also be significantly impacted by IASB standards, most notably IFRS 9, *Financial Instruments* and soon-to-be-issued IFRS 17, *Insurance Contracts*, which are or will be effective in 2021. These key drivers effect the time it would take to implement the proposed amendments because depending on the alignment of implementation date and the convergence and harmonization of the standards and regulations, the business requirements and systems development may have to be done multiple times and if the requirements differ enough there may be few synergies. This process could create a market burden on acquiring contractors and consultants.

There could be significant work involved to develop fair value models for market risk benefits, revise DAC and liability models, and create processes and controls around the new disclosures. Retrospective unlocking of cash flow assumptions and retrospective establishment of an Additional Liability could require particularly intensive development. As mentioned in the responses to Questions 8, 10 and 11 there would be some additional complexity specific to the proposed recommended solutions to the model for participating contracts.

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?*

DAC

We agree with the simplified transition proposed in the ASU. For consistency and comparability, the Board should allow or require companies to reduce the opening balance of DAC at the transition date if prior loss recognition was recognized by an increase in liability versus a reduction of DAC in accordance with their accounting policy under current guidance.

Liability for Future Policy Benefits

We recommend the transition approach described in ASC 944-40-65-2(d)(2) as the required transition method. This approach would be significantly simpler than the proposed full retrospective transition. We have concerns that a full retrospective transition would involve significant undue costs and effort, particularly for portfolios of insurance contracts issued or acquired decades ago for which reliable information may be no longer available.

At minimum, the transition provisions should include an option for entities to elect to apply the proposed transition described in ASC 944-40-65-2(d)(2) without having to demonstrate that a full retrospective application is impracticable.

Market Risk Benefits

We do not believe the proposed transition provisions are operable for market risk benefits. The proposed amendments in ASC 944-40-65-2(e)(2) require that the difference between the carrying value and fair value at the transition date be recognized as an adjustment to opening retained earnings (excluding amounts related to instrument-specific credit risk).

As discussed in the Proposed ASU, there are several current accounting models for contracts that meet the definition of market risk benefits. For those features currently accounted for as embedded derivatives, a common practice is to calculate an attributed fee that results in a zero fair value at the inception of the contract consistent with ASC 944-40-30-19B (a). For these features, the transition provisions are generally operational and should not be onerous to apply.

However, many embedded features that would qualify as market risk benefits under the proposed amendments are accounted for as an Additional Liability (either in whole or in part). For these features, all of the data required to determine an attributed fee that would result in a zero fair value at inception of the contract is not available. These product offerings could go back over a decade for many insurers. Additionally, it would be nearly impossible to develop the assumptions used in determining the attributed fee at the inception of these contracts without the bias of hindsight given the significant market changes that have occurred and policyholder behaviors that have emerged, particularly over the last ten years. Determining the attributed fee in this manner would, in our view, be deemed impractical per existing guidance in ASC 250-10-45-9.

Therefore, a practical expedient or additional guidance is needed with respect to transition for market risk benefits. We suggest the Board perform outreach and consider alternatives that use assumptions as of the transition date, two of which are outlined below:

- Entities would determine an attributed fee such that the fair value of the market risk benefits is calibrated to the carrying value for such features (when combining both embedded derivative balances and insurance accruals) as of the transition date. This alternative is consistent with the prescribed transition for DAC and the practical expedient for transition for the liability for future policy benefits in ASC 944-40-65-2(d)(2).
- Entities would retrospectively determine an attributed fee as of the inception of the contract but would use assumptions as of the transition date.

We believe either of these alternatives would eliminate the operational and impracticability issues outlined above.

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

We generally agree with the proposed transition disclosure requirements with respect to providing information required under ASC 250-10-50-1 through 50-3 in the year of adoption. However, we do not believe that such information should be provided on a disaggregated basis consistent with that which would be used for recurring disclosures. Providing information at this level would be unprecedented for an accounting change and would be quite voluminous, calling into question whether it would be beneficial to users, notwithstanding the significant additional cost for preparers.

We recommend that, for balance sheet transition disclosure purposes, the level of disaggregation should be limited to presenting the cumulative effect adjustment upon adoption as an adjustment to the beginning (i.e. transition date) balance in the DAC or liability rollforwards. For income statement transition disclosure purposes, we do not believe any level of disaggregation is warranted to achieve the Proposed ASU's objective of providing decision useful information to investors.

We believe that providing the most important information to the financial statement users is consistent with the FASB's and SEC's ongoing emphasis on the disclosure effectiveness.

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.

Overall, there are many significant costs involved in adopting the proposed amendments; however, as long as the issues identified in the participating contracts model are addressed as discussed in our responses to Questions 8, 10 and 11 and the discount rate for non-participating contracts appropriately reflects the liabilities as discussed in our response to Question 4, we believe the benefits would outweigh the costs because the financial statements would better reflect the economics and provide more decision useful information to financial statement users.

One-time costs include revising existing actuarial models, such as those applicable to the liability for future policy benefits, amortization of DAC and fair value, and creating new actuarial models. There would also be one-time costs for training. Ongoing costs include actuarial model maintenance, additional data capacity, additional actuarial staff and management, and controls (performance, documentation, and auditing).

There are several ways to make the proposed amendments more cost effective. Items that would particularly contribute to increasing the cost and complexity as well as adversely impacting transition timing are the costs for retrospective unlocking of cash flow assumptions, retrospective transition and retrospective establishment an Additional Liability. In the case of the latter, companies would need to retain all information and algorithms to perform a retrospective calculation of all nontraditional contracts since they would not know in advance which contracts may one day in the future exhibit a pattern of profits followed by losses. Since the Additional Liability uses essentially the same calculation approach as nontraditional DAC, this would eliminate much of the practical benefit of simplifying nontraditional DAC amortization. Throughout this comment letter we have provided more cost effective proposed approaches that produce even more meaningful results and we would be open to discussing these further.

APPENDIX – ADDITIONAL LIABILITY EXAMPLE

The problem with accruing an Additional Liability retrospectively upon recognition of a “profits-followed-by-losses” situation that emerges after contract inception can be demonstrated by the following example. Assume a 0% contract rate and no expenses. Assume a 6 year contract with the following values:

Scenario 1

Year	1	2	3	4	5	6
Assessments	\$130	\$135	\$140	\$145	\$150	\$151
Death Benefits	\$100	\$110	\$120	\$130	\$140	\$150
Margin	\$30	\$25	\$20	\$15	\$10	\$1

Because there are no losses, the reported profit each year would equal the margin. But assume a similar example but with a slightly different death benefit assumed in year 6:

Scenario 2

Year	1	2	3	4	5	6
Assessments	\$130	\$135	\$140	\$145	\$150	\$151
Death Benefits	\$100	\$110	\$120	\$130	\$140	\$152
Margin	\$30	\$25	\$20	\$15	\$10	\$(1)

Because there is now a \$(1) loss in year 6, there is a need to accrue an Additional Liability. The benefit ratio at a 0% discount rate would be 88%. The Additional Liability each year would be:

Year	1	2	3	4	5	6
Additional Liability	\$15	\$24	\$28	\$26	\$19	\$0

Profit each year would now be:

Year	1	2	3	4	5	6
Margin	\$30	\$25	\$20	\$15	\$10	\$(1)
Change in Additional Liability	\$(15)	\$(9)	\$(4)	\$2	\$7	\$19
Profit	\$15	\$16	\$16	\$17	\$17	\$18

Profit now emerges very differently than in Scenario 1, as a constant percentage of 12% of assessments (100% minus the 88% benefit ratio).

Now assume an insurer originally anticipated Scenario 1 but at the end of year 3 had a slight change in mortality assumptions putting it in Scenario 2. All expected cash flows are the same as before except for an expected additional benefit payment of \$2 at the end of year 6, causing a \$(1) loss in year 6. But under the proposed targeted improvements, the Additional Liability accrued in year 3 would not necessarily be the present value of the \$(1) loss or even the present value of the \$2 change in benefit payment. The

insurer may need to accrue a liability of \$28, far in excess of the expected loss or of the change in cash flows.

This would not be representative of the economics because it would include the impact of retrospectively switching from a profit release pattern based on margins to a profit release pattern based on a constant percentage of assessments.