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Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2016-330

Dear Ms. Cosper:

The Financial Reporting Executive Committee (FinREC) and the Insurance Expert Panel, both of the American Institute of Certified Public Accountants (AICPA), are pleased to offer comments on the FASB Proposed Accounting Standards Update, “Financial Services – Insurance (Topic 944) - Targeted Improvements to the Accounting for Long-Duration Contracts”, (the proposed ASU).

We support the efforts of the FASB to improve the existing recognition, measurement, presentation, and disclosure requirements for long-duration contracts issued by an insurance entity, and welcome the opportunity to provide comments and observations on specific sections of the proposed ASU. However, we strongly recommend that the Board formally field test the targeted improvements before finalizing.

We offer the following observations for FASB’s consideration:

Updating of assumptions for non-participating contracts: We support the updating of cash flow assumptions, recognizing that it provides more relevant information for users than today’s “locked in” approach. We believe that the prospective approach is the preferred approach for updating cash flow assumptions.

Discount rate for non-participating contracts: We agree with the principle implicit in the proposed ASU that the discount rate should reflect the risk free rate of the insurance liabilities, adjusted for liquidity. That said, we do not believe that a high-quality fixed-income instrument yield (interpreted as a AA rate) is a practical expedient that reflects this objective. We suggest that the Board perform further study and additional outreach to preparers and users to identify an index or other published rate that more closely aligns with this objective.

Participating contracts: We share a general concern with the industry that the proposed single model would not result in an accounting for participating contracts that appropriately reflects the underlying economics. The Board is proposing that participating contracts follow the same accounting model as non-participating contracts; however, given the unique characteristics of these products, we do not believe that this approach works. We recommend that the Board consider certain industry proposals being put forth to address these concerns.

Deferred Amortization Costs – Amortization: We agree with the proposed simplified approach for amortization of deferred acquisition costs but request that the Board consider providing clarification on the accounting for various situations as discussed further in the appendix.

Market Risk Benefits - Transition: We believe the Board should provide a practical expedient to the retrospective transition for market risk benefits, as an insurer would likely encounter similar issues with availability of historical data as the Board considered when determining the transition guidance for the liability for future policyholder benefits. In addition, if the benefit feature previously was not carried at fair value, on transition an insurer may need to perform hindsight analysis to determine the fair value which could lead to impracticability concerns as described in FASB ASC 250 when applying a retrospective transition approach for an accounting change. We recommend the Board perform outreach with preparers to better understand the implementation considerations for a retrospective transition approach. This information could be used to provide a practical expedient to the retrospective approach to address the known issues with the lack of historical data and the use of hindsight.

Disclosures: The majority of the AICPA Insurance Expert Panel believe that some of the proposed disclosures are excessive, not appropriate for financial statement footnotes, or do not provide decision-useful information.

The proposed disclosure requirements include specific and detailed disclosures that some members of the AICPA Insurance Expert Panel believe are excessive in many instances due to the fact that all the proposed disclosures are required for interim and annual periods. We recommend the disclosures be required for annual periods only and rely on the existing requirements of FASB ASC 270-10-50-1 for interim disclosures. The existing requirements already result in companies disclosing significant changes in estimates and financial position during interim periods and we believe this is the key focus of users during interim periods. Our suggestion is consistent with FASB ASU 2015-09 where most disclosures are annual only.

The Appendix to this letter provides FinREC and the Insurance Expert Panel’s responses to certain questions for respondents with additional justification to support our observations above.

We appreciate the opportunity to comment on the proposed ASU. We are available to discuss our comments with Board members or staff at their convenience.

Yours truly,

James A. Dolinar, Chair
Financial Reporting Executive Committee

Steve Belcher, Chair (2016-2017)
Insurance Expert Panel

Richard Sojkowski, Chair (2013 -2016)
Insurance Expert Panel

Appendix

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?

Comment

We agree with the scope of the proposed amendments on the accounting for the liability for future policy benefits for contracts other than participating contracts.

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?

Comment

We support the updating of cash flow assumptions for contracts other than participating contracts, recognizing that it provides users with a more current view of an insurance entity's expected future cash flows as compared to today's "locked-in" approach with a provision for adverse deviation. We believe that the prospective approach is the preferred approach for updating cash flow assumptions.

The retrospective approach may be viewed as the conceptually "purest" approach because it allows future profits to emerge on the basis of revised assumptions without carrying forward prior period effects of estimate changes to future periods. However, the reasons why a majority of the Insurance Expert Panel rejected the retrospective approach for updating cash flow assumptions include the following:

- it is operationally more complex, requiring the accumulation and maintenance of large amounts of historical data,
- like the existing estimated gross profits DAC amortization model, users would likely find the retrospective catch up nature of the calculation difficult to understand, and
- it causes a portion of the difference between actual vs expected assumptions in the current year to be offset through a retrospective adjustment.

We prefer the prospective approach for updating cash flow assumptions and recommend that the Board evaluate potential additional disclosures. We believe the prospective approach is a more appropriate approach, as it:

- results in more useful information providing current assumptions not retrospective assumptions muted by true-ups to past actual results,
- results in 100% of the difference between actual vs expected assumptions for the current period being reflected in the current year results
- avoids the data accumulation and maintenance burdens of the retrospective approach,

- accomplishes the FASB’s objective of simplifying insurance measurements and reporting, benefitting both preparers and users,
- greatly simplifies the transition guidance
- will be a widely recognized and used approach elsewhere in the world, as it is consistent with the recognition principles in the IASB’s proposed IFRS 17 accounting standard for insurers, which provides for a type of prospective recognition of margin,
- is consistent with other existing US GAAP models for financial instrument recognition, including the current prospective amortization approach for income relating to certain FASB ASC 325-40-35-4(a) beneficial interests (FASB ASC 325-40-35-4C under ASU 2016-13), and
- recognizes losses on a timely basis (using the 100% net premium ratio cap), while spreading margins over the life of the contract (consistent with the objective of a net premium approach).

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?

Comment

We agree with the annual updating of cash flow assumptions at the same time each year for contracts other than participating contracts. With regard to the requirement to update “more frequently if actual experience or other evidence indicates that earlier assumptions should be revised,” we request that the guidance be clarified to indicate whether the net premium ratio should be updated each reporting period if actual experience is different from expected in the current period (in addition to changes in expected future cash flows). Similarly, we believe clarification is needed on how the retrospective calculation interacts with the requirement to recognize experience adjustments in the current period. FASB ASC 944-40-35-6A (c) notes that experience adjustments “shall be recognized in the period in which that experience arises.” However, the retrospective calculation would seem to result in at least a portion of the experience adjustment being recognized in future periods given that the experience adjustment is implicitly captured in the retrospective calculation (because the retrospective calculation involves inclusion of both actual and projected cash flows).

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?

Comment

We believe using a high-quality fixed-income instrument yield to discount expected cash flows is operationally less burdensome than the 2013 proposal of a ‘top-down’ or ‘bottom-up’ discount rate method and some believe an improvement to existing guidance. While some members of the AICPA Insurance Experts Panel prefer to maintain existing guidance for the discount rate for

contracts other than participating contracts, the majority agree that the discount rate should reflect the characteristics of the insurance liability. Most members of the AICPA Insurance Expert Panel agree that the rate should be a current market-based liability rate, but are concerned that using a “high quality” rate as currently interpreted in US GAAP, during periods of market dislocation will result in locked-in income statement discount rates that do not faithfully represent the products. These members believe that using a fixed-income instrument yield less than high-quality, or the reference rate of a diversified fixed-income portfolio, would more faithfully represent a long-duration insurance liability discount rate. We have not been able to come to an agreement on which objectively determinable market rate should be used to best approximate the risk free rate plus an appropriate liquidity spread. We suggest that the Board perform further study and additional outreach to preparers and users to identify an index or other objectively determinable rate that more closely aligns with the principle implicit in the proposed ASU that the discount rate should reflect the risk free rate of the insurance liabilities, adjusted for liquidity.

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?

Comment

Yes, we agree that the effect of updating discount rate assumptions should be recognized immediately in other comprehensive income.

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?

Comment

The majority of our group agree that discount rate assumptions should be updated at each reporting date.

Liability for Future Policy Benefits—Participating Contracts

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?

Comment

We share a general concern with the industry that the proposed single model would not result in an accounting for participating contracts that appropriately reflects the underlying economics. The Board is proposing that participating contracts follow the same accounting model as non-participating contracts; however, given the unique characteristics of these products, we do not believe that this approach works. We recommend that the Board consider certain industry proposals being put forth to address these concerns.

As an extreme example, let’s assume that when interest rates rise, the expected increase in future investment earnings is completely offset by a commensurate expected increase in future

policyholder dividend payments such that there is no change in profitability from an economic perspective. The model in the proposed ASU would discount the higher expected dividend cash flows at a locked-in discount rate, resulting in an immediate loss in net income, all else being equal. The opposite occurs when interest rates drop, as lower expected policyholder dividends are discounted at a locked-in rate, creating an immediate gain in net income. This disparate treatment between discount rates and interest-sensitive cash flows means that even if there is no economic change to the contract because the dividend credited rate change exactly offsets the change in discount rates economically, there will be an impact to net income in that period. In order to ensure the accounting reflects the underlying economics, these interest-dependent liability cash flows must be handled consistently with changes in the liability discount rates.

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?

Comment

While we agree that cash flow assumptions should be updated on an annual basis for non-participating contracts, we have some concerns with respect to participating contracts. As discussed in our response to question 8, expected future dividend cash flows in participating contracts would most likely change as a result of changes in interest rates and 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 should be updated on an annual basis, changes in dividend credited rates should be required to be reviewed and updated as necessary each reporting period, consistent with updates to discount rates.

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?

Comment

The scope of benefit features that would qualify as market risk benefits under the proposed ASU would be limited to benefit features that are included in contracts where the contract holder has the ability to direct funds to assets segregated from other assets of the insurer. We are aware that insurers may have benefit features substantially the same as those that would qualify as market risk benefits, but because the assets backing these contracts that contain the benefit features are not segregated, the benefit features would not be in scope of the market risk benefit guidance. We were unable to reach a position to indicate whether we would agree or disagree with the scope of the proposed amendments on the accounting for market risk benefits as there were differing views.

If the Board intends to maintain the scope criteria for market risk benefits in the proposed ASU, we recommend a technical correction to eliminate confusion that could occur because the proposed ASU paraphrased sections of the current ASC 944 instead of repeating or referring to the guidance

directly. We believe the intent of the Board was to identify certain conditions included in FASB ASC 944-80-25-2 as those that need to exist for the underlying contract to enable a benefit feature to meet the “contract criterion” in the definition of a market risk benefit. If our understanding is correct, we recommend that the guidance in FASB ASC 944-40-25-25C(a) and the “contract criterion” in the definition in the Master Glossary for market risk benefit be replaced with the applicable existing guidance in FASB ASC 944-80-25-2. If our understanding is incorrect and the Board intended the criteria to deviate from the guidance in FASB ASC 944-80-25-2, then the Board needs to revise the qualifying guidance and explain how the guidance for qualifying as a market risk benefit differs from the related separate account guidance criteria in FASB ASC 944-80-25-2. We also believe that the guidance in FASB ASC 944-40-25-25C (b) should be more clearly described as account value protection and recommend that the following revisions to the first sentence: “Benefit: The insurance entity provides a benefit protecting the contract holder from adverse capital market performance of the separate account investment alternatives chosen by the contract holder, exposing the insurance entity to other-than-nominal capital market risk.”

Finally, we are unclear and request clarification on why FASB ASC 815-15-55-58, relating to guaranteed minimum interest rates, was removed. We do not believe the Board’s intention was to include these benefits as market risk benefits and would suggest the Board maintain this existing guidance which identifies that the benefit feature is not classified as an embedded derivative.

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?

Comment

Because we did not comment on the scope of market risk benefits, we are not in a position to indicate whether we would agree or disagree with the decision that all market risk benefits should be measured at fair value.

If the FASB ultimately decides to measure these benefits at fair value, we agree that the change in the instrument-specific credit risk should be recognized in other comprehensive income.

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?

Comment

No, we believe that investment contract acquisition costs should continue to be amortized under the interest method in Subtopic 310-20 and not included in the scope of the proposed amendments.

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?

Comment

We agree with the proposed simplified approach for amortization of deferred acquisition costs.

We also request clarification that an insurer is permitted, but not required, to use the new DAC amortization method for balances where insurance entities are electing to follow the current DAC amortization model today. Examples of these balances may be the “intangible asset” or “other liability” resulting from the difference between the fair value of the insurance contracts and the insurance contracts calculated under FASB ASC Topic 944, as well as the cost of reinsurance and the present value of future profits or “PVFP”. We believe the proposed transition guidance for DAC should be expanded to include these types of balances or insurance entities that wish to use the new DAC amortization guidance prospectively from the transition date.

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?

Comment

The majority of the AICPA Insurance Expert Panel believe some of the proposed disclosures appear somewhat voluminous with respect to frequency, not appropriate for financial statement footnotes or do not provide decision-useful information. Specific comments by topic follow.

Interim Disclosures

The proposed disclosure requirements include specific and detailed disclosures that some members of the AICPA Insurance Expert Panel believe are somewhat voluminous in many instances due to the fact that all the proposed disclosures are required for interim and annual periods. We recommend the disclosures be required for annual periods only and rely on the existing requirements of FASB ASC 270-10-50-1 for interim disclosures. The existing requirements already result in companies disclosing significant changes in estimates and financial position during interim periods and we believe this is the key focus of users during interim periods. Our suggestion is consistent with FASB ASU 2015-09 where most disclosures are annual only.

Deferred Acquisition Costs and Deferred Sales Inducements (FASB ASC 944-30-50-2A, 3)

Under the proposed accounting model, DAC and DSI amortization will no longer be linked to product profitability or liabilities. Therefore, a majority of the AICPA Insurance Expert Panel do not believe it is necessary to disaggregate the rollforwards by product type. These balances will no longer be volatile and a summarized rollforward should be sufficient to meet users’ needs.

Liability for Future Policy Benefits and Additional Liability for Annuitization, Death or Other Insurance Benefits (FASB ASC 944-40-50-6)

Separately disclosing expected future net premiums and expected future benefits results in a significant amount of detail and we are not certain this breakout provides meaningful information. The net premiums are not indicative of cash flows since they are only a portion of the gross premiums received from policyholders.

A majority of the AICPA Insurance Expert Panel do not believe the disclosure of undiscounted ending balances would provide decision-useful information. The disclosure of weighted-average duration provides insight into the expected time frame of the liabilities and we believe this is more meaningful.

Quantitative information about certain assumptions, such as mortality and lapses, is not expected to be decision-useful since the ranges will be very wide (0 to 100) and weighted averages will be difficult to calculate and understand, for example weighted average mortality such as x per thousand lives.

For the net amount at risk disclosure, we are recommending the existing disclosure requirements for guarantees in FASB ASC 944-80-50-1 be retained.

Liability for Policyholders' Account Balances (FASB ASC 944-40-50-7A)

A majority of the AICPA Insurance Expert Panel believe some of the proposed disclosures are not appropriate for financial statement footnotes since they focus on business strategy and not amounts within the financial statements. Those include the proposed disclosures in items b (1) for earned rate, and e about managing risks. The liability amount reported in the balance sheet for these products is not impacted by these statistics; therefore, we do not believe these should be in the audited footnotes.

For the net amount at risk disclosure, we are recommending the existing disclosure requirements for guarantees in FASB ASC 944-80-50-1 be retained.

Market Risk Benefits (FASB ASC 944-40-50-7B)

Since market risk benefits will be measured at fair value, a majority believe the existing rollforward disclosure requirements in FASB ASC 820-10-50 are sufficient. We believe all industries should have comparable disclosure requirements. For the net amount at risk disclosure, we are recommending the existing disclosure requirements for guarantees in FASB ASC 944-80-50-1 be retained.

A majority of the AICPA Insurance Expert Panel believe disclosures of managing risks arising from market risk benefits, including hedging activity, are not appropriate for financial statement footnotes. This hedging activity typically does not qualify as an accounting hedge. Therefore, we do not view this to be an accounting issue that would be relevant in the footnotes. There are no similar disclosure requirements in ASC 815 for all other derivative or hedging activities that do

not qualify for hedge accounting treatment. If the Board believes this type of disclosure should be included, we recommend that it should be more broadly considered as part of the FASB project on hedging.

Separate Accounts (FASB ASC 944-80-50-1)

For Separate Account products, the risk to the company is when guarantees are provided. Therefore, we believe the most decision-useful information focuses on this risk specifically and not on the Separate Account balance in aggregate. Policyholders receive annual financial statements of the Separate Account comprising their policy and this provides details on the performance of the specific funds they are invested in. We recommend that the proposed disclosure changes in this section be reversed. We believe the prior disclosures developed in AICPA SOP 03-1, now FASB ASC 944-80-50-1, provide the most meaningful disclosures of Separate Account guarantees and those should be retained. The volume of new sales/deposits could be included in the MD&A as that relates to business trends.

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.

None other than noted in our response to Question 18 above.

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?

Comment

When determining the effective date of the final guidance, we believe that the Board should consider that the adoption of the final guidance using a retrospective transition approach will require extensive time and effort.

We trust that the Board will also consider that there are several substantive new ASUs (FASB ASU 2016-13: Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments, ASU 2016-02: Leases, ASU 2016-01: Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities, ASU 2014-09: Revenue from Contracts with Customers) and Statutory Principle-Based Reserving that insurance entities will be required to adopt in the near future, not to mention many insurers subject to US GAAP also having to adopt IFRS 17, *Insurance Contracts*, effective January 1, 2021 for all or a portion of their business.

We believe that nonpublic entities should be granted additional time to adopt the final guidance, as this will be a significant undertaking of time and cost to adopt the new standard. However we believe that nonpublic entities that own public entities should be given the opportunity to early

adopt at the same time as public entities. Otherwise some nonpublic parents would have to unwind the new accounting model and retain a dual basis longer, resulting in additional costs and complexities.

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?

Comment

Market Risk Benefits: We believe the Board should consider providing a practical expedient to the retrospective transition for market risk benefits, as an insurer would likely encounter similar issues with availability of historical data as the Board considered when determining the transition guidance for the liability for future policyholder benefits. In addition, if the benefit feature previously was not carried at fair value, on transition an insurer would need to perform hindsight analysis to determine the fair value which could lead to impracticability concerns as described in FASB ASC 250 when applying a retrospective transition approach for an accounting change. We recommend the Board perform outreach with preparers to better understand the implementation considerations for a retrospective transition approach. This information could be used to provide a practical expedient to the retrospective approach to address the known issues with the lack of historical data and the use hindsight.

Other Considerations

Benefit Ratio: The proposed ASU indicates in FASB ASC 944-40-30-21 and 944-40-30-26 that the benefit ratio may not exceed 100 percent and will result in an immediate loss recognition. Based on the mechanical process of applying the benefit ratio model to estimate the additional liability we are unclear how capping the benefit ratio at 100 percent will result in an immediate loss recognition. We believe that the Board's intention was to perform an evaluation to determine whether there is a loss recognition event on the excess payments of the benefit feature and then modify the inputs into the benefit ratio calculation. We suggest the Board revise the guidance in FASB ASC 944-40-30-21 and 944-40-30-26 to describe what the immediate loss is intended to represent and how inputs to the benefit ratio calculation would be impacted if a loss recognition event occurred.