



Michael Monahan
Senior Director, Accounting Policy

May 16, 2012

Ms. Jennifer M. Weiner, Senior Practice Fellow
Financial Accounting Standards Board
401 Merrit 7
Norwalk, CT 06856-5116

Re: Insurance Contracts – Transition Guidance

Dear Ms. Weiner:

As a follow up to our recent conversations, the American Council of Life Insurers (ACLI)¹ welcomes the opportunity to provide comments on the transition guidance to be included in the FASB's Insurance Contracts Exposure Draft expected to be issued later this year. The ACLI represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. Our member companies represent over 90 percent of the assets and premiums of the U.S life insurance and annuity industry.

Background

This letter offers an approach to the transition guidance for the FASB to consider in developing their exposure draft for insurance contracts and for the IASB to consider as an alternative to the transition guidance contained in the IASB July 2010 Insurance Contracts Exposure Draft. The key objectives the ACLI has identified for transition guidance are as follows:

1. Recognition of pre-transition margins;
2. Comparable;
3. Cost-efficient and practical; and
4. Explainable.

The difficulty regarding transition stems from the fact that the residual or single margin building block will not represent a current measurement, but is an amount based on historical information. This results in the need to understand information and assumptions at the inception of the insurance contracts in force as of the transition date. This poses a challenge due to the long-term nature of many insurance contracts and in the situations where a block of business is acquired.

¹ The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S. life insurance and annuity industry.

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Under current guidance for changes in accounting principles (ASC 250-10 and IAS 8) when it is impracticable to determine the cumulative effect of applying the new standard to any prior period, the new accounting standard should be applied prospectively as of the earliest practical date. The guidance states that the balance carries forward from that date with no cumulative effect adjustment for the prior periods (ASC 250-10-55-12 and IFRS 8, paragraph 27).

It is unclear how this “prospective only” approach would be applied to insurance contracts. One interpretation is that policies in force immediately prior to the earliest practicable date would continue to be accounted for under existing GAAP. In the LIFO example (see ASC 250-10-55-12) the value of the FIFO inventory is not restated. The inventory is still carried on the balance sheet but is measured at the value that existed prior to the change in accounting principle and the balance isn’t restated. It seems that the current guidance could be interpreted to result in one of three scenarios; 1) continue to account for in-force contracts under previous accounting methods; 2) established a residual or single margin as the difference between the liability under previous accounting methods and the building blocks that are based on a current measurement (the fulfillment cash flows); or 3) de-recognize the difference between the fulfillment cash flows and the liability measured under previous accounting methods. Across the global insurance industry we observe different bases of accounting (U.S. GAAP, U.S. statutory accounting for mutual companies, and various methods across international jurisdictions), which creates a substantial concern with the first two methods described above and results in an incomplete valuation and material write-off of future profits from use of the third method.

Recommendation

ACLI believes that a full retrospective application should be the starting point for any transition approach. However, we recommend that the application guidance allow for the use of reasonable estimates when applying the standard retrospectively. If full retrospective application is not practical beyond a certain point, ACLI believes the boards should allow a practical approach that estimates the residual or single margin for contracts that are in force as of that date. Essentially, this practical approach to measure the residual or single margin would be an estimate of what the single margin would have been. The guidance should include required disclosures that allow users to understand and compare the impact of transition between companies.

ACLI believes principle-based guidance with a practical approach to measure the residual or single margin with appropriate disclosure will meet the key objectives.

Basis for recommendation:

Retrospective Adoption

During our consideration of an appropriate method of transition we determined that the guidance should be consistent with existing guidance for a change in accounting principle. We agree that full retrospective adoption is the preferred method. However, in many instances full retrospective application will not be possible. ACLI believes for many companies full retrospective application is appropriate and cost effective back to a point in time; after that point it becomes impractical. In many instances, due to the long duration of insurance contracts, it will not be achievable at all. This point in time will vary among companies and will even vary among types of contracts within a company. The earliest practicable date for full retrospective adoption will be impacted by many factors. For example changes in strategy; changes in product mix and features; acquisitions and disposition of policies could limit the ability to apply the full retrospective application. These considerations lead us to believe it is necessary to add provisions to the guidance that allow practical approaches while achieving the key objectives.

Estimates

Full retrospective adoption for the insurance industry poses significant challenges due to the duration of many contracts. Much of the information needed to perform a full retrospective adoption may no longer exist. For example, in many cases information material to the development of margins at the transition date, such as historical records of assumptions back to the original issue dates of policies, is no longer available. As a result, we believe it is essential that companies be allowed to use reasonable estimates when applying the guidance to all prior periods.

Practical Approach

For prior periods where full retrospective application is impracticable we propose that the guidance allow for a practical approach to estimate the residual or single margin. We believe it is reasonable to measure the liability that includes an estimate of remaining profits, i.e., margin, in the insurance contracts. If the resulting liability, when taking into account estimated remaining profits, is greater than the present value of fulfillment cash flows a residual or single margin is established.

Disclosures

ACLI believes an insurer should disclose qualitative and quantitative information that helps users understand how the insurance contracts standard was applied to prior periods. Due to the long duration of many insurance contracts the use of estimates in applying the standard to prior periods is inevitable; as a result, a description of such estimates should be disclosed.

Proposed Guidance

The suggested transition guidance is as follows and assumes that a single joint IASB/FASB exposure draft would be issued:

Effective date and transition

1. An insurer shall apply this [draft] standard for annual periods beginning on or after [date to be inserted after exposure].
2. An insurer shall fully apply this [draft] standard retrospectively to all prior periods, unless it is impracticable to do so. Impracticability should be determined for each portfolio of insurance contracts separately.
3. In cases where it is impractical to fully retrospectively apply the guidance to the inception date for a portfolio of insurance contracts, an insurer shall, as of the beginning of the earliest period from which full retrospective application is practicable, measure the fulfillment cash flows by applying this [draft] standard to the measurement of insurance net assets or net liabilities with a residual margin for remaining business inforce measured as described in paragraph 4.
4. At the beginning of the earliest period for which full retrospective application is practicable, an insurer shall calculate the liability for remaining business inforce, with a corresponding adjustment to retained earnings:
 - a. measure each portfolio of insurance contracts at the present value of the fulfillment cash flows.
 - b. for each portfolio of insurance contracts, establish an estimated residual margin that approximates that which would result from retrospective application.

- c. derecognize any existing balances of deferred acquisition costs and other deferred costs associated with insurance contracts (e.g. sales inducements, front end loads, etc.).
- d. derecognize any intangible assets arising from insurance contracts assumed in previously recognized business combinations. That adjustment does not affect intangible assets, such as customer relationships and customer lists, which relate to possible future contracts.

Effective date and transition – Disclosure

- 5. To help users of financial statements understand the impact of transition to this [draft] standard, an insurer shall disclose qualitative and quantitative information that allows users to understand methods, assumptions and resulting estimates used to apply this [draft] standard to prior periods.
- 6. An insurer shall disclose at a minimum the following at the portfolio level:
 - a. if full retrospective application is practicable for all prior periods disclose any significant assumptions and estimates used to applying this [draft] standard to prior periods
 - b. if full retrospective application is impracticable beyond a certain date (the “earliest practicable date”), disclose such date as well as the following information:
 - i. for contracts in force as of the earliest practicable date
 - 1. the present value of fulfillment cash
 - 2. the residual margin
 - 3. the method used to estimate expected remaining profit
 - ii. for each period presented, disclose the amortization of the residual margin associated with contracts that were in force and issued prior to the earliest practicable date
 - iii. as of the end of each period presented disclose the following amounts for contracts that are still in force and issued prior to the earliest practicable date:
 - 1. the present value of fulfillment cash flows
 - 2. the residual margin

Descriptive Example

- 7. The following is a description of one possible method to estimate the residual margin for remaining business in force as of the earliest date for which full retrospective application is practicable:
 - a. Develop profit expectations for the insurance contracts based on reasonable pricing assumptions as of the earliest practicable date
 - b. Estimate insurance contract liabilities that includes profit expectations as of the earliest practicable date
 - c. To the extent the estimated liability in (ii) is greater than the fulfillment cash flows, establish a residual margin

Other measurement methods may be applicable.

Conclusion

We appreciate the substantial amount of time and effort put in by staff with regard to the Insurance Contracts project. We hope that you will find the suggestions put forth in this letter regarding transition to be helpful. We would be pleased to discuss this with you further or answer any questions you might have.

Sincerely,

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

Michael Monahan
Senior Director, Accounting Policy

cc: Andrea Pryde, IASB staff