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Susan M. Cosper, Technical Director
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File Reference No. 2013-290

Dear Ms. Cosper,

Aflac, Inc. (Aflac) welcomes the opportunity to share with you our views regarding the Proposed Accounting Standards Update "Insurance Contracts (Topic 834)." Aflac acknowledges and appreciates the goals of the Board to create common high quality accounting guidance for insurance contracts, eliminate diversity in practice, and increase the decision usefulness of information regarding an entity's insurance liabilities.

Aflac Incorporated is a general business holding company and acts as a management company, overseeing the operations of its subsidiaries by providing management services and making capital available. Its principal business is supplemental health and life insurance, which is marketed and administered through its subsidiary, American Family Life Assurance Company of Columbus (Aflac), which operates in the United States (Aflac U.S.) and as a branch in Japan (Aflac Japan). Most of Aflac's policies are individually underwritten and marketed through independent agents. Additionally, Aflac U.S. markets and administers group products through Continental American Insurance Company (CAIC), referred to as Aflac Group Insurance. Our insurance operations in the United States and our branch in Japan service the two markets for our insurance business.

Aflac offers voluntary insurance policies in Japan and the United States that provide a layer of financial protection against income and asset loss. We continue to diversify our product offerings in both Japan and the United States. Aflac Japan sells voluntary supplemental insurance products, including cancer plans, general medical indemnity plans, medical/sickness riders, care plans, living benefit life plans, ordinary life insurance plans and annuities. Aflac U.S. sells voluntary supplemental insurance products including loss-of-income products (life and short-term disability plans) and products designed to protect individuals from depletion of assets (hospital indemnity, fixed-benefit dental, vision care, accident, cancer, critical illness/ critical care, and hospital intensive care plans).

Our general comments regarding the matters addressed in the Exposure Draft are as follows:
We support the efforts of the FASB and IASB towards convergence in the Insurance Contracts and Financial Instruments projects. Both projects entail sweeping changes for insurance companies that would require an exceptional amount of time, resources and analysis to implement properly. Additionally, efforts to comply with the proposed standards will require extensive systems modifications and capital expenditures.

We understand that the concept of having one or two measurement models rather than the multiple models under current GAAP guidance is valuable (e.g. ASC 944 and SOP 05-1). However, we have noted during our review that the proposed dual approach model contains significant complexity which can add a higher degree of subjectivity and lead to less consistency in practice. Therefore, we recommend targeted changes to improve current U.S. GAAP versus adopting a new standard. Requirement of additional disclosures may be a more reasonable alternative, rather than making such pervasive modifications to the existing guidance and accounting treatment. We recommend that the following changes from the FASB proposal be used as targeted changes to extant GAAP:

- Scope inclusions of all insurance contracts per the proposed guidance (with a few exceptions listed in Question 1 below).
- The insurance contracts definition per the proposed guidance.
- The insurance contracts boundary guidelines per the proposed guidance.
- Deferrable acquisition costs should also include unsuccessful efforts as they are considered when pricing products for profitability in practice.

For the industry and for users, the varying results from transition and recognition methods create significant issues requiring resolution. We agree there should not be a prescribed method to amortize the margin, and acknowledge that appropriate disclosure will be necessary to facilitate comparability. However, the different transition approaches, from the full retrospective approach to estimating as far back as reasonably possible, will create inconsistency from company to company. The different approaches result in differing impacts on opening equity, leading to disparate interpretations of the financial health of companies. Further, the complete change to the recognition and reporting of revenue is far-reaching and severe. The proposed insurance contracts revenue is derived from a calculation based on release from risk as compared to the extant current premium due method. As discussed in response to Question 31 below, because the premium due revenue is currently matched to changes in benefits and expenses via the insurance contracts' reserves additions or releases (included as a component of operating expenses), we do not believe the extant approach is wholly inappropriate. This exposure draft has been confusing, difficult to analyze and to interpret for industry experts and preparers. We have significant concerns that it will be even more difficult for financial statement users to comprehend such a complex approach.

As stated above, we believe extant GAAP with targeted changes is an acceptable model for measuring insurance contracts. However, if making targeted changes to extant GAAP is not considered a viable option by the Board, please consider our responses herein to the proposed exposure draft.

Our comments regarding Questions for Respondents are as follows:

Scope

Question 1: Do you agree with the scope and scope exceptions of this proposed guidance, including its applicability to contracts written by noninsurance entities? If not, what types of contracts or transactions also should be included or excluded from the scope and why?

Response: We generally agree with the scope of the financial assets that are included in this proposal with the exception of reinsurance and policy loan receivables which are specific to insurance companies. We have noted that policy loan cash flows are included within the fulfillment cash flows per proposed paragraph 834-10-55-79 and that policy loan receivables are included within the scope of the proposed standard for Financial Instruments-Credit Losses. Therefore, we recommend that reinsurance and policy loan receivables be covered under the insurance contract project in their entirety rather than be included in the Financial Instruments—Credit Losses proposed update. This would further converge this standard with that of the IASB, which includes reinsurance receivables in its insurance contract proposal.

<u>Recognition</u>

Question 2: Do you agree with the requirements included in this proposed Update for when noninsurance components of an insurance contract, including embedded derivatives, distinct investment components, and distinct performance obligations to provide goods or services, should be separately accounted for under other applicable Topics? If not, why?

Response: We agree and recommend that explicit clarification be added to illustrate how a whole life plan with a cash surrender value does not warrant separation of the investment component from the insurance component, since neither the insurance component nor the investment component can be measured independently without considering the other. Similar to the concept elsewhere in U.S. GAAP, these two components are clearly and closely related.

<u>Initial and Subsequent Measurement</u>

Question 3: Will the proposed measurement model produce relevant information that will help users of an entity's financial statements make economic decisions? If not, what changes do you recommend and why?

Response: No, we do not believe the proposed measurement model provides the most relevant information for users to make economic decisions, including our use of other entities' financial statements for peer and benchmarking analysis. The measurement model is an overly complex accounting and actuarial exercise. The ending results do not produce meaningful information for the users of the financial statements. The FASB has attempted to overcome known shortcomings in the proposed measurement model by requiring additional disclosures. However, the additional disclosures are extensive, and would only increase the already voluminous disclosures, with the result of obscuring relevant information for users of the financial statements rather than providing clarity.

Additionally, this standard is difficult for preparers to understand and it will be even more problematic for users to understand the modified financial results. It will take a great deal of effort to educate investors and other users of financial statements so that they can interpret and understand the extensive changes. This could result in investors lowering their investments in insurance companies.

Question 4: Which aspects of the proposed measurement model most significantly improve the information that will be used in making economic decisions and why?

Response: We do not agree that the proposed model improves the information that will be used in making economic decisions. For instance, liability cash flow assumptions that can be unlocked and a margin that cannot be unlocked will create confusion and volatility in the income statement.

<u>Measurement Approaches</u>

Question 5: Do you agree that entities should apply different approaches to contracts with different characteristics, described as the building block approach and the premium allocation approach? If not, which model do you think should apply and do you think there should be any changes made to that model?

Response: As there is a wide spectrum of insurance products, we agree that different approaches should be made available to entities for different types of products as prescribed by ASC 944. As an example, for long-term coverage such as Whole Life or an Individual A&H policy with guaranteed renewability, the building block approach is more appropriate. The premium allocation approach could be useful for Group A&H policies that are renewed annually. Under current GAAP, there are different valuation methods for different products. We believe different valuation methods are appropriate and should remain available under any new standard. Flexibility should be provided for an entity to determine the accounting policy that best fits the insurance product and is consistent across its business. This could avoid two very similar products having different accounting due to an arbitrary bright line.

Question 6: Do you agree that entities should be required to apply the premium allocation approach if the coverage period of the insurance contract, considering the contract boundary guidance, is one year or less? If not, what would you recommend and why?

Response: We recommend that entities be given an option to use either PAA or BBA when the coverage period is one year or less, instead of the proposed requirement to use PAA. This would relieve entities of the burdensome requirement to prove that they meet criteria for one or the other measurement model.

Question 7: Do you agree that entities should be required to apply the premium allocation approach if, at contract inception, it is unlikely that during the period before a claim is incurred there will be significant variability in the expected value of the net cash flows required to fulfill the contract? If not, what do you recommend and why?
Response: As mentioned in response to Question 6 above, we do not agree that companies should be required to use the Premium Allocation approach.

Portfolio and Contract Boundary

Question 8: Do you agree with the definition of a portfolio of insurance contracts as included in this proposed Update? If not, what do you recommend and why?
Response: No, we do not agree with the definition for the following reasons:

- The term portfolio is a term that in practice primarily relates to investment assets and not insurance contracts. In the Exposure Draft (Reference No 2013-220) of the Proposed Accounting Standards Update *Financial Instruments: Recognition and Measurement of Financial Assets and Financial Liabilities,* the term portfolio is used numerous times in reference to the underlying assets which support insurance contracts. We believe the use of the term portfolio in both investing and insurance activities will be confusing to both the users and preparers of financial statements. In practice many insurers use the terms block, cell, cohort, era, portfolio and have defined the terms as follows:
    - Block – Current line of business (such as cancer, long-term care, medical, or etc.)
    - Cell – Individual records (broken down by gender, age, duration, etc.)
    - Cohort – A group of issues that occurred at the same time, period or in the same quarter.
    - Era – Groups of policies that have the same valuation assumptions (for example the same interest or same morbidity).
    - Portfolio -- Refers to a group of assets (such as investments).

  Additions to the glossary and implementation guidance are needed to determine how the FASB definition of portfolio meets with the practice definitions above.
- The definition of “similar risks” per 834-10-55, paragraph 46, is too general and will lead to differing application in practice. For example, one insurer could establish portfolios based on types of insurance risk only, i.e. mortality, morbidity, etc. Alternatively, another insurer could establish portfolios based on both insurance risk and geographical risk.
- The definition of the characteristics “similar duration” and “similar expected patterns of release from risk” per 834-10-55, paragraph 46, suggest a high level of granularity. For example, 20 year olds and 60 years olds have different policy durations and therefore will not be able to be grouped into the same portfolio, even if they have bought the same product. This level of granularity is not operational. In BC120, the Board states that it considered requiring portfolios to be broken down to the line of business level, but decided against this partially because this would be fairly granular. It seems that the Board understands the operational difficulties associated with a high level of granularity and attempted to draft a definition that addressed this concern. However, the actual proposed definition is not operational and will lead to different interpretations in practice. Operationally, the definition appears to require that portfolios be disaggregated lower than product line, by age, duration, geographical area, and reporting period. This would result in an excessive number of portfolios to monitor and would result in very low population per portfolio for the onerous contract test.
- Lastly, the portfolio definition in context of timing, discount rates and changing assumptions needs clarification, specifically whether the Board believes every reporting period constitutes a new portfolio. We recommend that a portfolio be allowed to continue until a significant change, such as change in the risk or experience in the portfolio, is noted that represents a trend not a period-to-period difference or mere reporting period timing.

Monitoring all the potential portfolios and changes to assumptions will be costly and overly burdensome, particularly for long duration multi-decrement models, such as guaranteed renewable A&H policies. In summary, there is the lack of clarity around the definition of and guidance for implementation of portfolios.

Question 9: Do you agree with the requirements included in this proposed Update on contract boundary (that is, the requirements that establish how to identify the future cash flows that will arise as the insurer fulfills its obligations)? If not,

what do you recommend and why?
Response: Yes, we agree with the requirements on contract boundary included in the proposed guidance.

Fulfillment Cash Flows

Question 10: Do you agree with the types of cash flows that would be included in the measurement of the fulfillment cash flows, including embedded options and guarantees related to the insurance coverage under existing insurance contracts that are not separated and accounted for as embedded derivatives? If not, what cash flows do you think also should be included or excluded and why?
Response: We do not agree with the proposed types of cash flows included in the measurement of the fulfillment cash flows. We recommend that all relevant cash flows be included in the measurement of the liability, including commissions, premium taxes, and guarantee fund assessment that are paid to third parties. The IASB proposed guidance (paragraph B66) is preferable, as all relevant costs are included in the pricing of insurance contracts. The IASB proposal considers these known costs that are directly associated with the insurance contract (though these expenses are not paid directly to the policyholder). These costs are expected to have an impact on the profitability and margin of the insurance contract, thus are properly built into the pricing. To achieve a convergence objective, we believe it is important to have a common definition of fulfillment cash flows used by both the FASB and the IASB.

Question 11: Do you agree that the assumptions used in the measurement of the fulfillment cash flows should be updated each reporting period? If not, what do you recommend and why?
Response: We do not agree that the assumptions used in the measurement of the fulfillment cash flows necessarily require updating each reporting period. The proposed requirement appears to require stochastic analysis of all insurance contracts, which can be very costly and time consuming to implement. While stochastic analysis is an appropriate methodology and has been used in practice for variable annuity contracts, it is overly complicated and arguably does not provide better information for supplemental health insurance contracts.

The great majority of our products are long-term in nature with many assumptions, such as lapse, mortality, and various types of morbidity such as incidence and severity. These contracts require that assumptions be set many years into the future. Entities must exercise great care and judgment regarding when to update these assumptions. Often, as experience emerges, we take credibility into account and must allow more time to elapse before we update our assumptions. Thus, we do not agree that entities should update assumptions each reporting period, but should be given the latitude to update when there is an identifiable trend warranting change. Updating assumptions each reporting period will introduce unnecessary volatility in periodic earnings that may or may not be indicative of a longer term trend.

We believe this guidance should be clarified to be consistent with current ASU 944-40-30, paragraph 6, which uses best estimate assumptions as of the valuation date. Consistent with current practice, entities would monitor emerging experience and other information to determine if an update is warranted.

Question 12: Do you agree that the fulfillment cash flows for contracts measured using the building block approach and the liability for incurred claims for contracts measured using the premium allocation approach should be based on an explicit, unbiased, and probability-weighted estimate (that is, the mean) of the future cash flows, as of the reporting date, expected to arise as the entity fulfills the contract, adjusted to reflect any contractual linkage between the contract and any underlying assets? If not, what do you recommend and why?
Response: We recommend a best estimate of the future liability cash flows measurement approach for our products, which are primarily long-term A&H and Life. Under current GAAP, best estimates are used for loss recognition testing in a gross premium valuation, which we believe is appropriate. This type of assumption setting should be allowed to remain in place without the added burden of running extra scenarios. Entities should be given latitude in determining the necessity or lack thereof of running scenarios to develop liability cash flows, depending on the types of products and the credibility of company experience, rather than under the prescriptive methods and at each reporting period as proposed in the exposure.

Question 13: Do you agree with the approach in this proposed Update to recognize changes in estimates of cash flows (other than the effect of changes in the liability arising from changes in the discount rates) in net income in the reporting period? If not, what do you recommend and why?

Response: No, we do not agree with the approach in the proposed guidance to recognize changes in estimates of cash flows in net income in the reporting period. We recommend that the margin be unlocked if there is a change in future expectations. Changes in future expected profitability should be captured in the margin, as this is consistent with the view of insurance as a contract in which profits are earned over a long period of time in relation to the service obligation. If the margin cannot be unlocked, then favorable changes in future expectations will be recognized in profit immediately, which seems to be at odds with FASB's long-held view that gains are spread over the future. This view also needlessly adds volatility to the income statement for short-term changes that may or may not be indicative of long-term trends. In addition, since the present value of fulfillment cash flows itself is unlocked, unlocking the margin would be a natural extension of that concept. Updating assumptions which involve significant judgment could greatly impact current period results if the margin is not unlocked. Unlocking of the margin would result in more reliable financial statements, and would be easier for users to understand. We acknowledge the Board's concerns regarding transparency when unlocking the margin. However, we believe the required disclosure and separate presentation of the margin on the balance sheet provide adequate transparency.

Additionally, this method creates a mismatch in current income when projecting experience changes that will be recognized in one period. The adjustments for changes in estimates of future benefits/claims/premiums and the related reversals of those changes create operational challenges on how to adequately capture the adjustments in future periods because of potential overstatement or understatement. Cumulatively, the reversal adjustments will be difficult to implement. We recommend the margin be unlocked for changes in fulfillment cash flows. This change would simplify the financial reporting process, eliminate unnecessary short-term volatility and ease operational burden. The proposed disclosures require that material effects on the financial statements due to assumption changes be disclosed. Therefore, the proposed disclosures along with unlocking of the margin would provide transparency in the disclosure without creating volatility that may or may not be indicative of long-term trends.

Discount Rates and Discounting

Question 14: Do you agree that the discount rates used by the entity for nonparticipating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

Response: We do not agree that the discount rates used by the entity should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability. In theory, the discount rate using the characteristics of the insurance contract liability will generate a present value similar to that of fair value measurement. However, there are circumstances in which a present value that determines the profitability would be more relevant than a fair market value based on the exit price of the liability. We point to an excerpt in the Exposure Draft (Reference No 2013-220) of the Proposed Accounting Standards Update *Financial Instruments: Recognition and Measurement of Financial Assets and Financial Liabilities* regarding the subsequent measurement guidance for financial liabilities:

> BC135 states "…fair value measurement would be less relevant to users of financial statements in assessing future cash flows because it reflects the amount at which the liability could be transferred to another entity in the market and most liabilities are not transferred but, rather, are settled with the creditor."

The Board did acknowledge that fair value measurement would not be the most decision-useful information in all circumstances. In the case of insurance contracts, the liability is rarely transferred at the fair value, but rather the amounts are usually settled through payment of insurance claims. Even with transactions involving reinsurance, only in very rare cases are insurance liabilities novated. We believe the purpose of discounting is to calculate a present value that incorporates time value of money so that it can be compared to other present values using asset-yield discounting. In capital budgeting, projects are considered for profitability using cost of capital discounting to come to a net present value, and the practice is widely accepted. We believe the asset yield rate or the asset yield rate of a referenced asset portfolio, which is similar to the cost of capital concept, will be most relevant in considering the initial recognized liability by matching the decision making process of pricing of the insurance contract with the accounting treatment. The discount rate for insurance, therefore, should be that of the assets (or the referenced asset portfolio) backing the liabilities.

Question 15: For contracts measured using the premium allocation approach, do you agree that an entity should discount the liability for incurred claims? Do you agree that an entity should be allowed to elect not to discount portfolios when the incurred claims are expected to be paid within one year of the insured event? Why or why not? If not, what would you recommend and why?
Response: We do not agree that an entity should discount the liability for incurred claims using the premium allocation approach. We understand that the Board postulates that money has a time value, and an entity more faithfully represents its position when it measures its liabilities in a way that reflects the time value of money. However, this would only be beneficial if the increased cost due to the complexity of discounting outweighs the benefit of decision-usefulness of the information. We believe there will be minimal benefit for contracts which are measured using the premium allocation approach to be discounted, because the impact of discounting over such a short period is immaterial. An entity should be allowed to elect not to discount portfolios for the premium allocation approach.

Question 16: Do you agree that an entity should segregate the effects of underwriting performance from the effects of changes in discount rates (which would reverse over time) by recognizing changes in the present value of the fulfillment cash flows due to changes in the discount rates in other comprehensive income? If not, do you think that the effect of changes in the discount rates should be presented in net income? Please explain your reasoning.
Response: We agree that an entity should segregate the effects of underwriting performance from the effects of changes in discount rates. The time value of money is a vital concept in finance, and a critical component in decision making which should not be obscured by combination with other metrics. However, there is an inherent mismatch of fundamental theories between the insurance contract exposure draft and the Exposure Draft (Reference No 2013-220) of the Proposed Accounting Standards Update *Financial Instruments: Recognition and Measurement of Financial Assets and Financial Liabilities*. It is imperative that the concepts in the proposed insurance contract standard align with the concepts in the financial instrument standard to fully represent the balance sheet of an insurance company and the interrelationship of the assets which back these liabilities.

The current financial standard recognizes three measurement and classification categories: amortized cost ("AC"), fair value with changes through other comprehensive income ("FV-OCI"), and fair value with changes through net income ("FV-NI"). The classification of financial instrument assets ("FI"), based on the proposed exposure draft for Financial Instrument, depends on the business model and the cash flow characteristic of the FI. Under the proposed model to hold (to maturity), assets can be classified using AC only if the cash flow characteristic test of solely payment of principal and interest ("SPPI") is met. If the business model is to hold and to sell, assets can be classified as FV-OCI only if the cash flow characteristic SPPI test is met. In the proposed financial instrument model, we recognize the importance of the business model and that AC is a decision-useful classification. However, for insurance liabilities, there is a single view of the business model, resulting in changes due to interest being recorded in OCI. As a result, we believe there is a significant mismatch in the measurement of assets and liabilities.

We recommend that the measurement model be applied at the insurance portfolio level to closely match that of the assets backing these liabilities so that the changes in discount rates can either flow through OCI, NI, or remain at amortized cost. We propose the net present value discounted using the current discount rate be disclosed in parenthesis and footnotes, where applicable. This allows compatibility of the financial instrument assets backing the insurance liabilities in terms of subsequent measurement. This would provide more useful information for users of the financial statement regarding how assets and liabilities match, would decrease volatility in the income statement, and would provide sufficient disclosure for analytical purposes.

Question 17: Because the proposed guidance includes the approach under which changes in the insurance liability arising from changes in the discount rates should be recorded in other comprehensive income, do you think that a test should be required to trigger recognition in net income of some or all of the amounts in accumulated other comprehensive income (that is, a loss recognition test based on asset-liability mismatches)? Why or why not?
Response: We do not agree that a test should be required to trigger recognition. The total amounts in accumulated other comprehensive income would be due solely to interest rates only. By allowing the trigger recognition, the concept would be substantially different in current GAAP on financial assets' other-than-temporary-impairment ("OTTI") analysis. In asset OTTI analysis, if the unrealized loss is

due to the effects of interest rate only, no recognition to the earnings would occur. Similarly, if the amount in other comprehensive income is due solely to the effects of interest rate, no recognition should occur for insurance liability as this would reverse over time. This is also consistent with the Exposure Draft (Reference No 2013-220) of the Proposed Accounting Standards Update *Financial Instruments: Recognition and Measurement of Financial Assets and Financial Liabilities* in that no recognition would occur for financial instrument if unrealized loss is due to the effects of interest rates only (FV-OCI only).

Question 18: Do you agree that the method for calculating the discount rates should not be prescribed? Is the proposed guidance on determining the discount rates understandable and operable? If not, what do you recommend?
Response: We agree that the method for calculating the discount rate should not be prescribed. The proposed guidance on determining the discount rates is understandable, but operationally complex.

The first approach discussed in the exposure draft is the bottom up approach, which determines the discount rates for insurance contracts by using the risk-free rates plus a premium for illiquidity. A typical insurance liability can have cash flows that are beyond the observable market yield curve, requiring significant assumptions to extrapolate the proper risk-free rate associated with the liability. Measuring illiquidity premiums is very complex and is not operationally practical because there are no market observable ways to measure them. Furthermore, to accurately reflect insurance contract characteristics, model risk premium should be added to risk-free plus illiquidity premium, which further complicates the determination of a yield curve using the bottom up approach.

Model risk premium is associated with the relative complexity of an insurance liability, as compared to other liabilities. For example, treasury instruments are comparatively simple and risk free, thus not as subject to complexities in valuation. Conversely, an insurance liability involves multiple assumptions, such as mortality, lapses, and the timing of cash flows, all of which increase uncertainty and model risk. Some financial viewpoints consider model risk premium to be a separable component of illiquidity risk.

The second approach discussed in the exposure draft is the top down approach. The spread which is readily observable in the market is the market risk premium above the risk-free which incorporates both credit risk and liquidity risk, among other risks. The credit risk and the liquidity risk portion of the asset yield are rarely observable separately and can only be estimated. Even when the asset yield is adjusted to remove expected and unexpected credit risk, the remaining liquidity risk premium will still be different because assets can be typically traded, while insurance liabilities are rarely transferred (as compared to financial assets). The liquidity premium risk for the insurance liability should be much higher, as the market for insurance risk involves complex insurance entities while the asset market is usually very expansive.

Specific to our portfolio, we hold significant positions in Japan Government Bonds (“JGBs”) to back liabilities in Japan. A portion of our insurance contract liability portfolio would have an asset yield curve (or a reference portfolio) that is based entirely of JGBs, which use the risk-free rate. As a result, the top down approach would have the same starting point as the bottom up approach.

We believe that the asset yield rate is a more appropriate discount rate based on the factors discussed in response to Question 14 above, and that it is less complex and subjective.

Additionally, illustrative guidance is warranted for paragraph 834-10-30-11 which states the measurement of the fulfillment cash flows should exclude any factors that influence the observed rates but are not relevant to the insurance contract liability. We recommend clarification and implementation examples of how these factors would be excluded.

Question 19: Do you agree that interest expense generally should be based on the discount rates determined at the date the portfolio of contracts was initially recognized? Why or why not? If not, what do you recommend?
Response: We agree in theory that interest expense generally should be based on the discount rates determined at the date the portfolio of contracts was initially recognized. However, the application of the locked-in interest rate determined at that time will require keeping separate portfolios for each contract recognition date. This will result in a significant increase of portfolios and greater complexity by requiring the creation of new portfolios every contract recognition period. The cost and effort to maintain an increasing number of

portfolios in order to retain separate discount rates for each portfolio with similar characteristics would outweigh any user-decision usefulness provided by the granularity.

We recommend the Board provide an option that allows the discount rate calculated at contract recognition to be merged with existing portfolios that have similar characteristics using the weighted-average of the portfolio's yield curve. This method will simplify the process while maintaining the informational usefulness of the discount rates of the original contracts.

Question 20: Do you agree that upon any change in expectations of the crediting rates used to measure the insurance contract liability for insurance contracts with discretionary participation features, the interest accretion rates should be reset in a manner that recognizes any changes in estimated interest crediting and related expected cash flows on a level-yield basis over the remaining life of the contracts? If not, what do you recommend?
Response: Discretionary participation features should be added to the glossary of the proposed exposure draft. No further comments.

Margin for Contracts Measured Using the Building Block Approach

Question 21: Do you agree that an insurer should not recognize a gain at initial recognition of an insurance contract (such a gain would arise when the expected present value of the cash outflows is less than the expected present value of the cash inflows) but, rather, should defer that amount as profit to be recognized in the future? Why or why not?
Response: We agree that there should not be a gain at inception, which is consistent with current GAAP. Profits should be realized over the life of the contract instead of at issue, in keeping with the long-term nature of the risks insured. See response to Question 13 above regarding margin treatment not only at inception, but throughout the life of the contract.

Question 22: Do you support using a one-margin approach, as is included in this proposed guidance, or an explicit risk adjustment and a contractual service margin (as the IASB proposes)? Please explain the reason(s) for your view.
Response: We agree with the one margin approach, as it would be less burdensome and would simplify the calculation as compared to using two margins. However, the larger issue is not the number of margins but the potential unlocking of margins in situations where future expectations change, as well as the recognition methodology for the margin. See responses to Questions 13 and 25 for additional comments on unlocking and amortization of the margin.

Question 23: If you support a risk adjustment and a contractual service margin, do you agree with the IASB's approach to adjust the contractual service margin for changes in estimates of cash flows? Why or why not? Do you agree with the IASB's approach to not specify acceptable approaches to determine the risk adjustment? Why or why not?
Response: We agree with the FASB's one margin approach which does not include a risk adjustment. However, we agree with the IASB approach to allow an adjustment to the contractual service margin when future cash flow estimates are changed. It is appropriate for the IASB not to specify a methodology for determining the risk adjustment. This provides the entity with the latitude to use judgment and considers the wide range of products that are issued by insurers. We recommend that entities not be required to disclose the confidence level and other measures of the risk adjustment as this is proprietary and competitive information.

Question 24: Do you agree that a loss at initial recognition of a portfolio of insurance contracts should be recognized immediately in net income (such a loss would arise when the expected present value of the cash outflows exceeds the expected present value of cash inflows)? Why or why not?
Response: We agree that losses should be recognized immediately, consistent with current GAAP, which is appropriate for insurance contracts.

Question 25: Do you agree with the proposed method(s) of recognizing the margin (that is, as the entity is released from risk under the insurance contracts as evidenced by a reduction in the variability of cash outflows)? If not, what do you suggest and why?
Response: We do not agree with the proposed methods of recognizing the margin. For different products, there are different methodologies that are appropriate in defining "release from risk". As such, we suggest that entities be allowed to determine the

appropriate methodology. For instance, A&H products with claims paid more than once during the life of the policy will have a different pattern of release from risk than a life contract which pays a death benefit only.

Question 26: Do you agree that interest should be accreted on the margin and therefore affect insurance contract revenue? If not, why?
Response: We agree that it is appropriate to accrete interest on the margin. Entities should be given latitude to determine the interest accretion rate, taking into account the type of product and characteristics of the asset referenced portfolio.

Question 27: Do you agree that if the expected cash outflows (including qualifying acquisition costs) of a portfolio of insurance contracts will exceed the expected cash inflows, an entity should recognize the remaining margin immediately in net income? Why or why not?
Response: We do not agree, since present value of future cash flows is not sufficient information to determine whether a portfolio is in a loss position. By itself, present value of expected remaining cash outflows netted against present value of expected remaining cash inflows does not indicate the need to recognize a loss. Historical projected and actual cash flows must also be considered, which would be burdensome to track in addition to application in the proposed measurement model. We recommend that FASB more clearly define loss positions in the proposed standard. Additionally, we believe it is more appropriate to unlock the margin prospectively for loss recognition.

Acquisition Costs

Question 28: Do you agree that the direct acquisition costs presented with the margin should include only the costs directly related to the entity's selling efforts that result in obtaining the contracts in the portfolio and that all other acquisition costs should be recognized as expenses when incurred? If not, what do you recommend and why?
Response: We do not agree. See the response to Question 29 below.

Additionally, the illustrative guidance in paragraph 834-10-55-153 concerning acquisition costs not yet recorded should be clarified to demonstrate the differences of this application from current GAAP.

Question 29: Do you agree that the measurement of the margin for contracts measured using the building block approach and the liability for remaining coverage for contracts measured using the premium allocation approach should be reduced for direct acquisition costs incurred? If not, what do you recommend?
Response: We do not agree. The guidance provided for the treatment of direct acquisition costs is overly complicated, and the separate treatment of the costs adds an unnecessary level of complexity which will likely confuse users of the financial statements.

Insurers currently include acquisition costs, both successful and unsuccessful, when pricing products for profitability. Thus, both successful and unsuccessful acquisition costs should be included in the measurement of fulfillment cash flows, as well as all other cash outflows. Inclusion of these costs will lead to a better representation of the margin on a portfolio of insurance contracts, and a better measurement for loss recognition, if necessary. This approach will also converge with that proposed by the IASB.

Question 30: Do you agree that an entity should recognize acquisition costs as an expense in net income in the same pattern that it recognizes the margin for contracts measured using the building block approach or in the same pattern that it reduces the liability for remaining coverage under the premium allocation approach? If not, why not?
Response: We recommend that acquisition costs related to both successful and unsuccessful efforts should be included within the measurement of fulfillment cash flows. However, if the Board decides to require acquisition costs to be separately aggregated and reduced from the margin, we agree that acquisition costs should be recognized in net income in the same pattern the margin is recognized. We agree with the proposed guidance that changes in the assumptions to determine the present value of acquisition costs can be unlocked, which results in less tracking and complexity.

Insurance Contract Revenue

Question 31: Do you agree that users of financial statements would obtain relevant information that faithfully represents the entity's financial position and performance if, in net income, for all insurance contracts, an entity presents insurance contract revenue and incurred expenses, rather than only information about changes in margins (that is, the net profit)? If not, why not?

Response: We do not agree with the proposed guidance on the recognition of insurance contract revenue. The revenue recognition model is unsuitable for insurance accounting, and the insurance industry cannot conform to a manufacturing or service industry's financial model. The proposed guidance results in the flawed conclusion that the higher the costs, the higher the revenue. At the end of the reporting period the derived insurance contract revenue would have to be reconciled to premiums due in order to develop a meaningful metric. The significant additional disclosures are so overwhelming that they move from providing useful additional insight to creating disclosure overload and confusion – individually the disclosure may be good but all disclosures considered as a whole are difficult to digest for a user of the financial statements.

Additionally, we do not agree with the 2010 proposed summarized margin presentation approach. Under the summarized margin approach and the current proposed guidance, the focus of the performance of insurance contracts is shifted from premiums and claims to changes in the measurement of the insurance liability. Both models present a fundamental change to the way revenue of insurance contracts is presented. Premiums and claims are a very important performance metric that users and preparers use to assess the profitability of insurance contracts. The current presentation reflects premium due revenue less the operating expenses, which includes the changes in reserves. We do not believe extant GAAP is an unacceptable revenue approach and therefore suggest the Board consider retaining current GAAP, with targeted changes as noted above and inclusive of additional disclosures for recognition.

Question 32: Do you agree that, for all contracts, revenue should exclude any amounts received that an entity is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs and that expenses should exclude the corresponding repayment of those amounts? If not, what do you recommend? Please specify whether your view depends on the type of contract.

Response: We do not agree. We believe that estimated returnable amounts represent claim expense, and further, are part of a policy's premiums. As such, we recommend that the estimated returnable amounts continue to be included in revenue, as well as claims expense.

Question 33: For contracts measured using the premium allocation approach, do you agree that if the contract has a financing component that is significant to the contract, an entity should adjust the liability for remaining coverage to reflect the time value of money and recognize the accretion of interest with insurance revenue? Do you agree with the practical expedient that an entity should not be required to reflect the time value of money in measuring the liability for remaining coverage (that is, if the entity expects, at contract inception, that the time period between when the policyholder pays all or substantially all of the premium and when the entity provides the corresponding part of the coverage is one year or less)? If not, what do you recommend and why?

Response: No comment.

Question 34: For contracts measured using the building block approach, does this proposed Update contain sufficient guidance on how to determine insurance contract revenue in accordance with the principle that it should be allocated between reporting periods as performance obligations are satisfied over time (that is, to allocate consideration between periods by reference to the relative value of the services provided in each period)? If not, explain what additional guidance is necessary.

Response: We do not agree with the proposed guidance in the determination of insurance contract revenue. The revenue is derived using a very complex computation. The exposure draft completely dispenses with the existing metrics of determining insurance premium revenue, and application of the proposed guidance will produce varying results among insurers. The proposed "release of margin" is an actuarial calculation using statistical factors such as standard deviation based on probability distribution. It would be better to summarize the margin information in the notes to the financial statements than create a new model. Additionally, the earned premium approach does not reflect the economics of an insurance product, as the premiums due metric should drive the revenue. The new earned premium definition is not based on true incoming premiums. Additionally, the earned premium approach is so complex it will be difficult to implement in the related accounting and actuarial systems. Further, the term "earned premium" is not defined in the glossary. Currently, revenue is adjusted for changes in the insurance reserves so that net profit is not based entirely on premiums due. We believe extant GAAP is an acceptable revenue approach and therefore suggest the Board consider retaining current GAAP, with targeted changes as noted above and inclusive of additional disclosures for recognition.

Participating Contracts

Question 35: Do you agree that participation features that are contractually dependent on the performance of other assets or liabilities of the insurer or the performance of the entity itself should be measured on the same basis used to measure the underlying items and changes in the measurement should be presented in the same statements (that is, net income or other comprehensive income)? Do you agree that this approach should be limited to only participating features for which the amount of the performance of the underlying items passed through to policyholders is contractually determined and not extended to participating features that allow an entity discretion about the amount of the performance of the underlying item to pass through to the policyholders? If not, what do you recommend and why?
Response: No Comment.

Reinsurance

Question 36: Do you agree that a cedant should record a margin if the expected present value of the cedant's future cash inflows exceed the expected present value of the cedant's future cash outflows (thus prohibiting the recognition of a gain at inception upon entering into a reinsurance arrangement) for (a) retrospective reinsurance contracts accounted for using either the building block approach or the premium allocation approach and (b) prospective reinsurance contracts accounted for using the building block approach? If not, what do you recommend and why?
Response: No comment.

Question 37: Do you agree that a cedant should estimate the fulfillment cash flows (including the ceded premium) for a reinsurance contract using assumptions consistent with those used to measure the corresponding fulfillment cash flows for the underlying insurance contract or contracts, without reference to the margin on the underlying contracts? If not, what would you recommend and why?
Response: No comment.

Insurance Contracts Acquired in a Business Combination

Question 38: Do you agree that entities should record a loss at the acquisition date in the amount by which any excess of the asset and liability balances related to insurance contracts measured in accordance with the guidance in this proposed Update exceeds the fair value of those assets and liabilities? Do you agree that entities should record a margin (not an immediate gain) for the amount that the fair value of the asset and liability balances exceeds those assets and liabilities measured in accordance with the guidance in this proposed Update? If not, do you think an entity should instead increase or decrease goodwill for the differences between the fair value and the measurement in accordance with the guidance in this proposed Update on those assets and liabilities? Why or why not?
Response: No comment.

Contract Modifications

Question 39: Do you agree that for a substantial modification (a) an entity should recognize a gain or loss as the difference between the measurement of the modified contract using the current entity-specific price that the entity would hypothetically charge the policyholder for a contract equivalent to the new contract and the carrying amount of the existing contract and (b) that the carrying amount of the existing contract should be derecognized? If not, what do you recommend?
Response: No comment.

Presentation

Question 40: Do you agree with the presentation requirements included in this proposed Update? If not, what would you *recommend and why?*

Response: We do not agree with the presentation requirements. We have the following comments regarding presentation requirements in the proposal:

- Underwriting margin, which is presented in the statement of earnings, is an actuarial term. As proposed, underwriting margin is a net calculation which has no clear definition. Additionally, use of the terms margin and underwriting margin in the proposed standard create additional confusion due to different meanings. Both terms are currently used in the industry with different interpretations than the exposure draft. Consideration should be made to change margin to earnings, since the underwriting margin is a component of earnings from a financial statement impact.
- Regarding ceded reinsurance consideration and claims/benefits incurred in reinsurance, we recommend that an option be allowed to provide disclosure in the notes to the financial statements, rather than requiring that the information be presented on the face of the financial statements.
- We suggest the option to combine assets and liabilities under PAA and BBA on the face of the financial statements and disclose the components in the notes to the financial statements.
- We recommend the option to present the insurance contracts assets and liabilities net on the face of the balance sheet and disclose the components in the notes to the financial statements.
- As stated in response to Question 31 above, insurance contracts revenue is a very complex calculated number. It will require a bridging note to reconcile revenue derived per the proposed standard to premiums due. We recommend robust illustrative guidance to bridge the two revenue models if the derived revenue approach is retained.
- We recommend that for presentation within the Statement of Comprehensive Income, the adjustment for changes in estimates of future benefits/claims and reversals of those changes be grouped together with claims/benefits incurred, and the components be disclosed in the notes to the financial statements.
- Both the balance sheet and statement of comprehensive income are very detailed under the proposal (as described in several of our responses above). We prefer the proposed IASB format which provides a more simplified model.
- We recommend inclusion of an illustrative Statement of Cash Flows.
- The requirement that the interest accretion on the insurance contracts liability and net margin be reflected in the interest expense line on the Statement of Comprehensive Income could require insurers to adjust bank covenants with financial institutions. Currently the impact of interest accretion is not required to be included in interest expense, and we do not believe that it should be included. There are currently other liabilities that require interest accretion which do not require the change due to interest accretion to be reflected in interest expense, such as pension liabilities.
- The interest accretion of the insurance contracts liability and net margin will result in interest expense from operating activities on the Statement of Cash Flows. We believe the change in insurance contract liability and margin include the interest accretion portion, and interest expense should not be broken out separately in the Statement of Cash Flows.

Disclosure

Question 41: Do you agree with the disclosure requirements included in this proposed Update? If not, which disclosure requirement(s) would you change and why? Are there any additional disclosures that would provide decision-useful information and why? Do you think that any of the disclosure requirements included in this proposed Update would not provide decision-useful information and should not be required? If so, which ones and why?

Response: As proposed, the disclosures are excessive and overly detailed at the cost of clarity and decision usefulness. The proposed disclosures require two to three times the information currently required. We recommend that disclosure requirements be reviewed and streamlined to maintain a high level of clarity and usefulness, and that materiality of the information being disclosed also be a factor. The risk information (paragraphs 834-10-50-28 through 35) is overly prescriptive. Some risk information is currently disclosed in the MD&A section of the quarterly and annual public filings. We are concerned that the details in the assumptions required to be disclosed in the proposal will expose proprietary pricing information, especially if the level of portfolio is disaggregated on a granular level. Further, we are very concerned about the ability to gather information and prepare these disclosures in the amount of time available to prepare quarterly and annual reports. The overwhelming amount of disclosure requirements related to the risks arising from insurance contracts is not necessary, and reduces the disclosures' usability. Additionally, non-GAAP measures will need to be added to the disclosures and/or MD&A to ensure the financial analysts have all of the existing metrics for comparison during the transition and educational years, which will only increase the disclosures required under the proposed guidance. As such, we recommend that the following proposed disclosures be removed:

- Paragraph 834-10-50-12 – Reference number 32 above. We do not agree the estimated returnable amount should be deducted from revenue and claims expense.
- Paragraph 834-10-50-27 – This sensitivity narrative disclosure is too complex, too detailed and gives more proprietary information than is warranted.
- Paragraph 834-10-50-28 and 29 – This risk information is more suitable to the MD&A section of the quarterly and annual public filings.
- Paragraph 834-10-50-31, 32 and 34 – This insurance risk information provides proprietary information and should not be required.
- Paragraph 834-10-50-33 – Reinsurance credit risk is required to be evaluated currently. The disclosure requirement is duplicative and excessive.

Additionally, there is very little illustrative guidance relating to disclosures. We suggest that additional illustrative guidance be provided in the proposed guidance, particularly for paragraph 834-10-35-5 –- disclosure required for change in fulfillment cash flows and other comprehensive income.

Effective Date and Transition

Question 42: The Board will establish the effective date of the requirements when it issues the final amendments. However, the Board is interested in determining the key drivers affecting the timing of implementation. What are those key drivers? How do those drivers affect the time it will take to implement this proposed guidance?

Response: Significant changes will be required to implement the proposed ASU such as: (1) new and additional sources of information must be developed or obtained; (2) internal controls must be designed and added; (3) current systems providers must make enhancements to the current systems; (4) systems and internal processes must be completely redesigned to enable reporting requirements; and (5) education must be provided internally and externally to all stakeholders. While some of that education will happen concurrently with other activities, it is another component added to items which must be considered when determining the length of time required to implement. Based on the numerous requirements, we recommend a three to five year implementation time frame from the date of the new guidance is finalized.

Additionally, the timing should be coordinated with the finalization of the financial instruments standards. As indicated in our answers to Questions 16 and 17, the financial instruments standards do correlate with the insurance contracts guidance. The changes to the financial instruments and insurance contracts standards will require additional capital resources and internal and external personnel resources. With the massive industry implementation, the external consultant resources will be limited and the cost of external providers will significantly increase.

Question 43: Do you think the effective date should be the same for both public and nonpublic entities? Do you think the effective date should be the same for regulated insurance entities and other entities that issue insurance contracts within the scope of this proposed guidance? Why or why not?

Response: No comment.

Question 44: Do you agree that the practical expedients relating to transition included in this proposed guidance are sufficient for retrospective application (that is, are the transition provisions in this proposed guidance operable)? If not, what would you recommend and why?

Response: The practical expedients provided for transition are not sufficient to alleviate the effort required. Methods of applying available information and judgment to retrospectively derive the margin on portfolios of contracts issued in prior periods can vary among entities. Fully retrospective application of the proposed guidance will be a very time intensive and expensive process. Additionally, we believe it will be difficult to exclude hindsight in the estimation of the margin on portfolios of contracts issued in prior periods.

We recommend that the Board model the impact of the exposure draft to understand the significant operational impacts at transition. Additionally, we would be willing to assist the Board in field tests of the proposed guidance. Based on discussions with accounting and actuarial consultants, most companies, including Aflac, have not been able to model the impact of transition due to time constraints during the comment letter period. The transition impact could result in unfavorable results for an insurance company, such as a return on equity strain in which revenue will never be recognized (the release of built up gains in reserves will have the effect of increasing equity at transition which would have the resulting effect of decreasing return on equity), and which can reduce equity on a prospective basis which impacts covenants, capital ratios, and analyst statistics. The transition results could distort the financial health of an insurance entity, and lead investors to no longer invest in the industry.

Question 45: For business combinations that occurred before the transition date, is the requirement included in this proposed Update on reallocating the fair value of the asset and liability balances related to insurance contracts between the expected fulfillment cash flows and the margin operable? Why or why not? If not, what would you recommend and why?
Response: No comment.

Question 46: Do you agree that the proposed approach to transition would provide users of financial statements with relevant information that faithfully represents the entity's financial position and performance in a way that appropriately balances comparability with verifiability? Why or why not?
Response: As stated in our response to Question 44 above, the potential variability in judgment used to estimate the margin on portfolios of contracts issued in prior periods raises a concern regarding consistency and comparability among reporting entities.

Costs and Complexities

Question 47: Describe the nature of the incremental costs of adopting the guidance in this proposed Update, distinguishing between one-time costs and ongoing costs. Explain which aspects of the guidance in this proposed Update are driving those costs and include ideas to make the proposal more cost effective.
Response: Systems, consulting and training costs will be significant one-time costs. Since the exposure draft changes all of the insurance metrics for actuarial systems and financial statements, these costs will also be substantial. As stated in response to Question 42 above, specialized consultant costs will be higher due to the high demand and low supply. Ongoing system maintenance and control reviews will be higher on an ongoing basis. Audit cost will increase and most likely will continue to be higher on an ongoing basis.

During the financial crisis, the insurance industry as a whole remained strong. Even for companies with insurance subsidiaries which had difficulties during the crisis, the insurance businesses remained strong. The belief of the FASB that an entirely new insurance model is necessary is unwarranted, particularly when the industry faces constant regulatory change, including health care reform, Dodd-Frank, NAIC Solvency Modernization and Solvency II initiatives. These accounting changes will require millions of dollars for implementation. At a recent insurance contracts exposure draft round table event, the majority of insurance companies estimate the cost of implementation will exceed $50 million per company. Even disregarding cost, it is not clear that the proposed approach would be better than the existing approach for analysts. Improvements may be more reasonably achieved through additional disclosures rather than wholesale replacement of the extant guidance. We contend the benefits to U.S. capital markets will not outweigh the cost of conversion of the proposed guidance.

Question 48: Describe the nature of the incremental costs of auditing the financial reporting requirements included in this proposed Update, distinguishing between one-time and ongoing costs. Explain which aspects of the model in this proposed Update are driving those costs.
Response: No comment.

Additional Comments:
We appreciate the Board's efforts thus far in providing clarity and convergence on various standards. In that regard, we strongly recommend that the Board evaluate the impact of the proposed standard changes in conjunction with proposed changes to the Exposure Draft (Reference No 2013-220) of the Proposed Accounting Standards Update *Financial Instruments: Recognition and Measurement of Financial Assets and Financial Liabilities*. Additionally, we suggest the Board consider regulatory changes that are also in varying stages of implementation that will impact the Insurance Industry (i.e. Dodd-Frank, NAIC Solvency Modernization and Solvency II initiatives). Specifically, we recommend that the Board undertake a project to model an insurer's financial statements under the proposed accounting standard changes, in conjunction with the other proposed regulatory changes, to clearly vet the impact on the industry's liquidity, capital adequacy and financial health prior to requiring any proposal stage literature to become effective. We believe that a thorough modeling project will identify additional considerations and concerns on how the various accounting and regulatory changes interrelate that have yet to be uncovered.

Thank you again for your consideration. If you have any questions or concerns regarding our comments please feel free to contact June Howard, SVP and CAO, or Resh J. Reese, 2nd VP of Accounting Policy, at (706) 323-3431.

Sincerely,

June P. Howard
Senior Vice President and
Chief Accounting Officer