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October 25, 2013

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

**Re: *Exposure Draft - Proposed Accounting Standards Update  
Insurance Contracts (Topic 834)  
File Reference No. 2013-290***

Prudential Financial, Inc. (the “Company”) appreciates the opportunity to provide comments on the Proposed Accounting Standards Update Insurance Contracts (the “Exposure Draft” or “ED”). Prudential Financial is a financial services leader with approximately \$1.044 trillion of assets under management at June 30, 2013. The Company’s insurance businesses, which primarily offer life insurance, annuities and other products, are industry leaders in the United States and Asia with over \$3 trillion of life insurance in force as of December 31, 2012. Accordingly, we are keenly interested in the FASB’s work in developing a comprehensive standard for accounting for insurance contracts that appropriately reflects the economics of the business.

In developing our comments on the proposed insurance standard, we focused on the following three objectives, which we believe are the principles that must be achieved before considering any changes to current U.S. GAAP. The standard should:

- Result in financial statements that are relevant to users and enhance comparability among issuers, which is critical in light of current major differences among issuers globally. The continuation of these differences in the face of a new industry wide standard undermines the credibility of any such standard, especially given the potential significance of these differences to the capital markets and regulators;
- Reflect financial results that correspond to the economics of the business and how the business is actively managed. The Company believes that there should be a strong linkage to fulfilling our obligations and the corresponding investments we hold to fulfill such obligations; and,
- Be cost effective to operationalize, especially when weighed against the benefits to be derived by the user communities.

We believe that the FASB and the IASB (the “Boards”) have made significant progress in their joint deliberations for insurance contracts. We would encourage the Board to continue to work jointly with the IASB to develop a single global standard. We would like to acknowledge that the standard as proposed attempts to address many of the concerns we expressed in our 2010 comment letter on the Preliminary Views Discussion Paper.

However we have serious concerns that the ED does not fully achieve the objectives outlined above. In particular, we believe that critical enhancements are required in the following areas to address certain shortcomings:

1. Reflecting the economics of the business
2. Comparability of financial results across the industry
3. Complexity in both implementation and ongoing administration
4. Relevance and appropriateness of presentation and disclosures

We would be supportive of the proposed standard if the above concerns are addressed and appropriate consideration is given to the tradeoffs between costs, both implementation and on-going, and the benefits to users of the financial statements.

In addition, the requirements and timing of the ED need to consider and be aligned with other proposed accounting standards (i.e, Financial Instruments inclusive of Hedging). Decisions that appear reasonable in isolation may lead to unintended consequences when looked at holistically. Without such consideration these efforts will result in a flawed accounting model that will not produce financial results consistent with the economics of our business.

In providing comments on the ED, the Company has considered, among other things: (1) the modeling the Company performed collectively as part of the Group Field Testing – a collective effort involving ManuLife, MetLife, New York Life, and Prudential Financial (“the Group”) as further described in Comment letter No. 8; (2) our own field testing on several products in support of the FASB outreach project; and (3) reviews of the proposed ED with each of our key business and corporate centers including actuarial, finance, investment management areas, etc. While the work we have performed to date is informative, it has been somewhat limited given the length of the comment period and it is clear to us that more detailed and extensive field testing is required to more fully understand the ED’s implications.

We have expanded on the critical enhancements below, more fully documenting the nature of our primary concerns. Additional thoughts are included in the detailed responses to the ED’s specific questions in the attached appendix.

### **1. Reflecting the economics of the business**

Our business model is premised on satisfying our obligations to our customers which generally extend over a significant period of time, and in responsibly managing assets to fulfill those obligations. Given the critical inter-relationship between assets and liabilities in the pricing and management of long duration life insurance liabilities, we believe it is essential that the ED recognize the economics of this relationship. Central to our business model is Asset Liability Matching (“ALM”) whereby we manage assets such that funds will be available at the time needed to make payments to customers. As currently drafted, the ED will result in accounting volatility that does not reflect the underlying ALM economics of how we manage the business. We believe that volatility in the financial statements recorded within comprehensive income is appropriate when it is

economically driven. In other words, it should reflect any mismatch between the insurance liabilities and the assets supporting them. To provide for this result, we believe the proposed modifications to the ED outlined below would result in a better reflection of the economics of our insurance products after giving appropriate recognition to our ALM processes.

- *Discount Rate:* We believe the discount rate used to measure the insurance contract liability should be reflective of the rates implicit in the pricing of the business. These rates are representative of our expectations of the investment results, inclusive of expected defaults, to be achieved throughout the life of the contracts to fulfill our obligations to the customer, and are a better reflection of the characteristics of the insurance contract liabilities than the top down or bottom up rates proposed by the ED. Reflecting interest expense, i.e. unwinding of the initial discount, consistent with pricing aligns the reported results with the economics of the products.

We are concerned that measuring the liability at rates disconnected from both the implicit rates in the pricing, which generally assumes asset defaults based on long term averages, and the underlying asset portfolio will give rise to significant non-economic volatility. For example, changes in credit spreads reflecting current market sentiment but not indicative of long term credit defaults and expectations, would impact asset values without a corresponding impact on insurance liabilities. Use of our proposed approach would eliminate this non-economic volatility because using a pricing approach which considers current spreads but is reduced for expected default rates will result in better matching of changes in assets and liabilities values.

We are also concerned that using discount rates that are consistent with observable current market rates beyond the point on the yield curve where such rates are neither derived from active markets nor even exist will create significant accounting volatility in liability values. Long-term liabilities are extremely sensitive to small movements on the long end of the yield curve. As part of its work, the Group tested the sensitivity of the insurance contract liability for certain retirement products to movements in the rates beyond 30 years. Its testing indicated that a 50 basis point parallel shift upward resulted in more than a 5% movement in these liabilities. Given the magnitude of our long duration insurance liabilities and the unobservable nature of long term rates, every effort should be made to reduce artificial and misleading volatility. We believe the ED should provide that the use of a discount rate grading to a long-term average rate beginning at the point at which observable inputs are less relevant would be an acceptable alternative. This should be accompanied by disclosure of the methodology and significant assumptions used, including sensitivities to alternative assumptions.

Additionally, the proposed requirement to unlock the discount rate for those contracts with discretionary participation features (principally Universal Life type products), while conceptually sound, has proven to be practicably difficult to implement and will introduce non-economic volatility. We believe the approach proposed by the American Council of Life Insurers (the "ACLI") achieves the objectives of the ED and produces results more in line with the economics of the business.

- Matching through Other Comprehensive Income: While we think it is appropriate that the effects of the changes in the discount rate are segregated from changes in measurement of fulfillment cash flows, we are concerned that reflecting all discount rate changes in other comprehensive income (“OCI”) will result in volatility in both income and equity that is both non-economic and confusing to the extent similar OCI treatment does not apply to all of the assets supporting the liabilities. The “geographic” requirement in the ED does not fully reflect the long-term nature of insurance and the linkage between these liabilities and the assets supporting their fulfillment. Economic volatility should only emerge and be reported in either net income or other comprehensive income when an insurer’s assets and liabilities are not economically matched.

We believe the Board should consider providing specific guidance for assets within the financial instruments classification and measurement standard when those assets are backing liabilities in the scope of the Insurance Contracts standard. Specifically, we believe the Board should include a FV-OCI option when measuring financial assets that support insurance contract liabilities. Without such an option, there will be instances where assets supporting insurance contract liabilities will be measured at either amortized cost or FV-NI, while the corresponding liability will be measured at current value with the effects of changes in discount rates reported in OCI, resulting in material noneconomic accounting volatility. Inclusion of the FV-OCI option would provide for better alignment in the measurement of the financial assets and financial liabilities that are associated with insurance contracts, and be more appropriately reflective of the ALM economics.

Additionally, we believe the hedging programs of insurers would also then need to be uniquely addressed when the Board completes its work on macro-hedging. This would ensure the accounting for insurers’ hedges are appropriately aligned with the accounting for their hedged items, i.e. the insurance contract liabilities.

Additionally, we believe the use of OCI to reflect the changes in discount rates should be optional on a portfolio by portfolio basis if it provides for better alignment with the accounting for assets supporting the respective portfolios.

- Margin Unlocking: We are concerned that the requirement to reflect all changes in estimates of all future fulfillment cash flows (other than the effect of changes in the liability arising from changes in discount rates for non-participating contracts) in net income will result in unwarranted volatility that is not reflective of the business economics, and be of little practical value. As currently proposed, the margin represents the expected profit of an insurance contract at its inception. Prospective unlocking of the margin for changes in estimates of all future fulfillment cash flows (other than the effect of changes in the liability arising from changes in discount rates for non-participating contracts) is needed to result in a faithful representation of this view throughout the life of the insurance contract. While unlocking will result in changes in future margin amortization, differences in current period cash flows as a result of actual cash flows differing from expected cash flows would be recognized immediately within income. This would generally be consistent with the IASB contractual service margin approach and a positive step towards convergence.

Unlocking the margin for favorable developments would also be consistent with the prohibition to recognize gains at inception, as it would prevent the recognition of gains after issue that would not have been recognized if the updated assumptions had applied originally. Unlocking the margin better aligns the need for loss recognition when margins have been depleted over time. Without unlocking of the margin, gradual deterioration of profitability will be reflected at a single point in time rather than as the experience emerges.

## **2. Comparability of financial results across the industry**

Consistency and comparability across the industry is one of the principle objectives to be achieved through the implementation of the proposed standard. We do not believe the proposed guidance as currently drafted adequately addresses the significant inconsistency currently existing today under U.S. GAAP with respect to the identification of embedded derivatives resulting from the living benefit riders on variable annuity products. The proposed guidance continues to point to Subtopic 815-15 for the determination of the appropriate treatment for these riders, leaving in place the guidance under this subtopic as it currently exists. Unfortunately, there are certain ambiguities within the current guidance that have resulted in diversity of practice across the industry on the treatment of certain types of options and guarantees, especially those related to guaranteed minimum benefit type riders on Variable Annuities (VA). We believe the diversity in practice is regrettable under the current standards but would be inexcusable in the “new” world.

As a consequence, under U.S. GAAP today certain variable annuity riders follow derivative fair value accounting, subjecting them to measurement incorporating risk margin and the company’s own credit risk, while these same riders others are measured under the insurance standard with no reflection of risk margins or own credit risk. Also, the effects of changes in the discount rates of derivatives are currently reported in net income, while the effects of changes in discount rates for contracts measured under the ED will be reported in other comprehensive income. We strongly believe that any comprehensive insurance standard that does not address this material diversity in practice would be a failure on the part of the Board. While we recognize the complexities of addressing this, issuing a standard that fails to resolve this diversity would be an unacceptable outcome to us. It should also be an unacceptable outcome to those who regulate the capital markets and to those regulatory bodies that rely on GAAP financial statements. To address this issue, we recommend incorporating the accounting for all such VA riders within the scope of the ED. As previously mentioned, we believe the Board should include a FV-OCI option for assets backing insurance liabilities, including derivatives. Further, the Board should continue work with the IASB for convergence, as the embedded derivative guidance within the two frameworks are not aligned and could result in divergent accounting for the riders associated with these products.

## **3. Complexity in both implementation and ongoing administration**

We appreciate the FASB’s measured and deliberate approach to the Insurance Contracts project. While the current proposal attempts to address many of the industry’s concerns, it nevertheless is highly complex and represents sweeping changes from current industry standards. These changes have severe systems and process implications.

- ***Implementation Timing:*** Before the standard is finalized, we strongly suggest more extensive field testing to fully understand its implications. This will be required to fully understand the extent and nature of changes necessary to enhance the actuarial models and other systems to meet the ongoing reporting obligations under the new standard. A key dependency to implementing the standard will be the development and testing by third party providers of the actuarial software necessary to support the required reporting. Our expectation is that software vendors will require approximately 2 years to deliver upgraded products once the standard becomes final. Additional time will then be required by preparers to (1) purchase and/or implement the necessary systems and effect the process changes necessary to implement the standard; (2) educate management, staff and the investing community, and (3) develop the necessary management reports to align with the new standard. Collectively to address these items, we believe a minimum of five years will be required to implement the standard once finalized.
- ***Transition:*** While we are appreciative of the practical expedients contemplated in the ED, implementation which requires restatement of multiple years remains a significantly complex and time consuming undertaking. Given the long dated nature of our business, developing an understanding of the performance of the portfolios over time will require significant judgment and data collection efforts. We strongly encourage the Board to consider allowing preparers the option to use the benefit of hindsight in determining the cash flows necessary to determine the margin at the transition date. The use of this approach will alleviate significant operational burdens for preparers and significantly improve both verifiability and comparability among preparers for pre-transition business, while still providing a margin at transition that faithfully represents the profit remaining for those contracts in force at that date. While we recognize this will result in less comparability between pre- and post-transition business, we believe that such treatment is warranted and will provide a relevant measure of financial position. In addition, we believe that some of this complexity would be mitigated if unlocking the margin was permitted.
- ***Fulfillment Cash Flows/Portfolio Definitions:*** Alignment of the FASB and IASB definitions for both fulfillment cash flows and portfolio is an additional area where we believe convergence must be achieved. If not, we believe global companies will be required to track, measure and report financial results at multiple levels and bases, which will be extremely burdensome and costly. In addition, we are concerned that the proposed definitions in the ED are overly complex and could lead to a significant expansion in record keeping requirements. The requirement to track portfolios that “have similar duration and similar patterns of release” will expand the number of portfolios beyond what is necessary to accurately measure results and reflect the economics of the business. Different definitions of fulfillment cash flows will inhibit comparability across the industry and we believe that the Boards should converge to a principle reflective of the way we manage the business.

#### **4. Relevance and appropriateness of presentation and disclosures**

- ***Earned Premium:*** We do not believe that the proposed revenue approach for insurance contracts provides decision useful information, and would be an extremely cumbersome process to produce. As currently proposed it is a somewhat mechanical approach and is not reflective of the contractual rights of the company. For example, insurance contract revenue,

which represents an allocation of revenue across periods, may be inadvertently used as a volume metric for business sold during the period. We believe that revenue should be more reflective of the cash flows under the contract, which would be more reflective of the economics of the business. As an alternative, we would support the model being proposed by the ACLI.

- Segregated Funds: We do not agree with the requirement to disaggregate and present separately in the income statement the investment earnings and interest credited to segregated funds. We believe the current approach of netting such amounts is more representative of the economics of the business. The proposed inclusion of the investment earnings will make the evaluation of management's ALM strategy less transparent, which is critical to the fundamental understanding of the financial results. This requirement would also complicate the preparation of the statement of cash flows for no benefit. Additionally, we believe the current GAAP single line reporting on the statement of financial position for both segregated fund assets and liabilities should be continued as disaggregation provides no beneficial information to users.
- Volume/Level of Disclosures: While we agree with the general disclosure principles included in the exposure draft, we are concerned that the volume and depth of the proposed disclosures is so overwhelming as to compromise their usefulness to financial statement users, and inhibit their ability to understand what is important in evaluating the financial statements. Additionally, these requirements may lead to the disclosure of proprietary information.

Included in Attachment A are the detailed responses to some of the questions posed in the Exposure Draft which specifically relate to the concerns identified above. For the remainder of the questions, we reference you to the industry responses incorporated in the comment letter submitted by the ACLI. We appreciate the opportunity to comment on the Exposure Draft and hope that you take our comments under consideration. Should you have any questions or desire further clarification on any of the matters discussed in this letter or the attachment, please contact Robert Boyle, Deputy Controller, at (973) 802-2220, or me at (973) 802-9257.

Sincerely,



Robert M. Falzon  
Executive Vice President & Chief Financial Officer

Enclosed – Attachment A

## Comment Letter Appendix

### Responses to questions

We have responded below to those questions we believe are relevant to the concerns we expressed in our cover letter. With respect to the remainder of the questions, we are in general agreement with the industry views as expressed in the American Council of Life Insurers comment letter to the Board.

***Question 1:** Do you agree with the scope and scope exceptions of the 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?*

Partially agree. We would ask the Board to consider issues of potential inconsistency across the financial services sector as it relates to classification of certain contracts. In particular, whether investment-type products having contingent annuity options, and typically sold in the retirement market, are classified either as insurance or as financial instruments. These products would now appear to qualify as insurance under the proposed ASU. However, similar type contracts sold by banking institutions without the annuitization option are and would continue to be treated as financial instruments. The substance of these types of contracts is largely the same during the accumulation phase as the annuitization option is not elected until late in life, generally at retirement. We believe the Board should address the inconsistency of classifying these products as insurance when the risks are predominantly financial. We would ask that the Board clarify that these late in the contract life features be considered outside the scope of insurance contracts.

***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:**

Under the proposed ASU, embedded derivatives, distinct investment components and distinct performance obligations are intended to be separated and separately measured prior to the application of the model(s). We believe the proposed requirements are an improvement to the requirement proposed in the 2010 Discussion Paper, however, we believe the proposed guidance does not adequately address issues of inconsistency currently existing today under U.S. GAAP with respect to the identification of embedded derivatives. While the guidance points to Subtopic 815-15 for the identification, there are certain ambiguities within the guidance resulting in diversity in practice across the industry on the treatment of certain types of options and guarantees, especially those related to guaranteed minimum benefit type riders on Variable Annuities. We believe the diversity in practice is regrettable under the current standards but would be inexcusable in the “new” world.

As a consequence, under GAAP today certain variable annuity riders follow derivative accounting (measured at fair value), subjecting them to current measurement incorporating risk margin and the company's own credit risk, while others are measured under the insurance standard with no reflection of risk margins or own credit risk. Also, the effects of changes in the discount rates of derivatives are reported in net income, while the effect of changes in discount rates measured under the ED are reported in other comprehensive income ("OCI"). We strongly believe that any comprehensive insurance standard that does not address this material diversity in practice would be a failure on the part of the Board. While we recognize the complexities of addressing this, issuing a standard that fails to resolve this diversity would be an unacceptable outcome to us. It should also be an unacceptable outcome to those who regulate the capital markets and to those regulatory bodies that rely on GAAP financial statements.

To address this issue we recommend incorporating the accounting for all such VA riders within the scope of the insurance contracts standard. Consistent with the ED's current measurement model, changes in the estimated value of the rider guarantees would be transparent under the insurance contracts model. Further, this would help to eliminate the existing complexity within the embedded derivative accounting model of having to determine whether bifurcation and measurement are required under a different standard. Additionally, this would be consistent with the objectives of a converged standard, as the IASB proposal it would be less likely to result in separation for these items.

In addition, we believe the Board should include a FV-OCI option for assets backing insurance liabilities, including derivatives, as noted in our response to Question 16.

### **Initial and Subsequent Measurement**

***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?*

***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 for Q3 and Q4:**

We do not believe the measurement model as currently proposed will produce relevant information for users. As outlined in our cover letter and within the responses to these questions, we believe certain changes are critical to making this proposed standard viable. In particular, adjustments for the following are needed:

1. Revisions to the discount rate methodology in recognition of the critical link with asset-liability matching ("ALM").
2. Changes to allow for the prospective unlocking (as proposed by the IASB) of the Margin for changes in assumptions impacting the fulfillment cash flows, and

3. Modification to the use of the level interest rate approach for discretionary participation features as outlined in our response to Question 20.

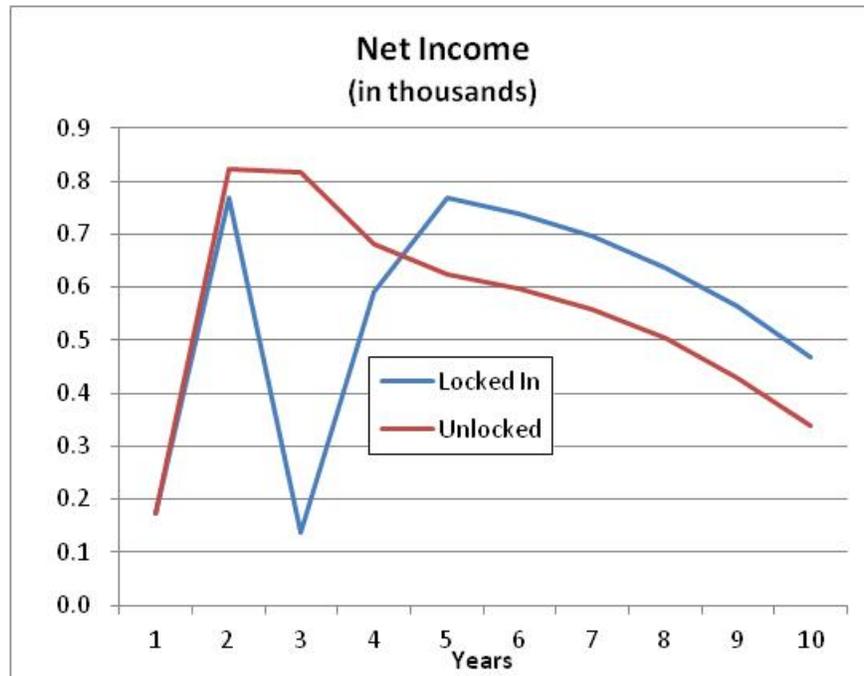
We do believe that the use of updated and current assumptions for measuring the fulfillment cash flows is an improvement that will enhance the information available to users. We would be supportive of the proposed standard if the above concerns are addressed and appropriate consideration is given to the tradeoffs between costs, both implementation and on-going, and the benefit to users of the financial statements. In addition, we believe the requirement to present the explicit margin and changes therein is an improvement in that it provides enhanced transparency for users as to the drivers of profitability.

***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:**

We do not agree with the approach to recognize changes in estimates of cash flows in net income for the reporting period. We believe the margin should be unlocked for changes in estimates of future cash flows. This would generally be consistent with the IASB contractual service margin approach and would be a very positive step towards convergence. Otherwise, unlocking fulfillment cash flows and not unlocking the margin is internally inconsistent. Unlocking the margin more appropriately matches up with changes in the expectations of how future cash flows and profits will emerge.

The following hypothetical example compares the impact of not unlocking the margin versus the impact of unlocking for a simple ten-year level term product where it is assumed expectations change as to the pattern of future death claims (mortality) in years 3 and 4. The modeled changes in mortality are neither extreme nor are they inconsistent with the magnitude of changes typically made as part of a regular updating of mortality assumptions. Clearly, the unlocked margin approach produces a more representative view of the pattern of unearned profit.



As discussed in our response to Question 27, unlocking the margin would also eliminate the volatility associated with recognizing the entire remaining margin in net income at the point that the expected cash outflows exceed expected cash inflows (i.e., at the point of initial loss recognition).

Further, as discussed in our response to Question 44, an approach that allows for unlocking the margin will reduce the complexity of measuring the margin at transition as it eliminates the need to discern the historical assumptions in effect the business was issued. This will also improve the comparability among companies.

Should the Board adopt a risk adjustment as a separate building block we also believe it would be appropriate to adjust the margin for changes in the risk adjustment related to future coverage or future services.

**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 appreciate the Board recognizing that a prescriptive bottom up approach is limiting and insufficient given the nature of insurance liabilities and the use of the top down approach is an improvement from the DP. However, we believe that a more suitable approach that considers the economics of the product would be more appropriate. Insurance contracts are priced assuming companies will earn a certain anticipated yield on invested assets resulting from funds being received earlier in the contract life than benefits are being paid. As such, we believe the Board should further consider a pricing based rate as an option as well. These rates are representative of our expectations of the investment results to be achieved throughout the life of the contracts to fulfill our obligations to the customer, and better

reflect the characteristics of the insurance contract liabilities than the top down or bottom rates as proposed by the ED. This approach would more directly recognize the economics of the transaction and would continue to allow for differences between actual and expected interest earnings to flow through profit and loss.

We are concerned that measuring the liability at rates disconnected from both the implicit rates in the pricing, which generally assumes asset defaults based on long term averages, and the underlying asset portfolio will give rise to significant non-economic volatility. For example, changes in credit spreads reflecting current market sentiment but not indicative of long term credit defaults and expectations, would impact asset values without a corresponding impact on insurance liabilities. Use of our proposed approach will eliminate this non-economic volatility. Using a pricing approach which considers current spreads but is reduced for historical default rates will result in better matching of changes in assets and liabilities values.

In addition, we believe the proposal will result in inconsistent treatment across the financial services industry and will drive undue strain at issue for products with heavy investment components such as single pay deferred annuities (“SPDA”) and Structured Settlements. We believe that the proposal will result in significantly different discount rates for Structured Settlement contracts that are sold without life contingencies (Financial Instruments) or with life contingencies (Insurance Contracts), despite the same pricing methodology for generating investment spread income.

***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:**

Partially agree. As noted in our cover letter, we believe it is crucial for non-economic volatility to be minimized and for the financial statements to faithfully represent economic volatility where it exists by recognizing the importance of Asset-Liability Matching to the industry. As such, we would request that the Board consider the long term nature of insurance liabilities and the interrelationship between liabilities and assets in determining the financial statement geography for recognition of each.

We believe the Board should consider providing specific guidance for assets within the financial instruments classification and measurement standard when those assets are backing liabilities in the scope of the Insurance Contracts standard. Specifically, we believe the Board should include a FV-OCI option when measuring financial assets that support insurance contract liabilities. Without such an option, there will be material instances where assets supporting insurance contract liabilities will be measured at either amortized cost or FV-NI, while the corresponding liability will be measured at current value with the effects of changes in discount rates reported in OCI, resulting in material noneconomic accounting volatility. Inclusion of the FV-OCI option would provide for

better alignment in the measurement of the financial assets and financial liabilities that are associated with insurance contracts, and be more appropriately reflective of the ALM economics.

Additionally, we believe the hedging programs of insurers would also then need to be uniquely addressed when the Board completes its work on macro-hedging. This would ensure the accounting for insurers' hedges are appropriately aligned with the accounting for their hedged items, i.e. the insurance contract liabilities.

Additionally, we believe the use of OCI to reflect the changes in discount rates should be optional on a portfolio-by-portfolio basis if it provides for better alignment with the assets supporting the respective portfolios.

***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:**

No, we do not believe that such a test should be required. As currently written, it is possible for OCI to develop significant negative variances due to an accounting mismatch between liabilities and assets that is not indicative of the actual economics of the portfolio and could result in inconsistent treatment depending on the assets used to back the business. In addition, such a test would increase the complexity of the accounting exercise without clear benefit to the users of the statement.

***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:**

Partially agree. We believe that it is appropriate to recognize the linkage between changes in discount rates and crediting rates for products with discretionary participation features. However, we have concerns that the approach may not result in an appropriate result in certain cases. We support the approach as outlined in the ACLI comment letter in which the discount rate would not be level in instances where the expected credited rate is not constant.

**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 believe it is important for the Boards to converge in this fundamental area. However, we think the appropriate approach would be for a single margin which is unlocked as compared to the IASB approach of an explicit risk adjustment and a contractual service margin which is also unlocked. The incorporation of an explicit risk adjustment and a contractual service margin would add complexity while providing limited value in terms of meaningful information for users.

In addition, multiple approaches are used throughout the industry to measure risk. We are concerned that these multiple approaches would reduce comparability of the resulting financial statements between companies and further limit the value of the risk adjustment for users.

**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:**

Under the proposed accounting model, the release of the margin has a significant impact on net income. To the extent there are no experience variances, the underwriting margin will equal the margin release. While a portion of the margin reflects future expected profits for the entity, it also implicitly includes provision for overhead, investment expenses, and other similar costs. For these reasons, we believe the pattern of margin release to be critical.

The concept that the margin is recognized into income as the entity is released from risk has merit. However, this may not work well in all situations. One such situation would be where the back ended recognition of the margin results in releases in early periods that are insufficient to cover current overhead and other similar costs. Another such situation is with regard to contracts where there may be indications that most of the risk has been released only to be proven wrong later. This may result in the premature recognition of the margin that will not be available later when it becomes clear that there is still non-trivial risk remaining. We suggest an approach similar to that used in the 2010 IASB ED where margin release is based on time unless the pattern of claims or benefits makes another pattern more appropriate.

Some products accounted for under the Premium Allocation Approach may have a settlement period which extends for many years (e.g. Group long-term disability (“LTD”)). For such products, the amortization of the margin over the coverage period and not the settlement period ignores the variability of cash flows related to benefit payments. Mitigation of this volatility is a significant component of the value proposition to our customers, and a key element in pricing. Consequently, adverse experience during the settlement period will result in increased volatility in net income as there is no longer any margin to offset the adverse experience. We prefer there be an option to amortize the

liability for future coverage over both the coverage and settlement periods for PAA contracts.

We welcome more clarity on the intended meaning of “variability of cash flows” to better understand how these calculations are to be implemented. Additionally, we ask the Board to clarify that the approaches to release the margin based on timing, similar to the examples in the Update, are acceptable and that an entity is not necessarily required to follow the more complex approach based on frequency/severity as shown in example 16. While paragraph 834-10-55-137 indicates that determining release from risk is a matter of judgment and should be based on facts and circumstances unique to the entity and to the nature of its insurance contracts, paragraphs 834-10-55-138 to 55-139 indicate that all of the criteria described in those paragraphs should be considered. It is unclear whether a simplified approach, such as those described in Examples 14 and 15, would meet all the criteria set forth. We are concerned that despite the approach being “a matter of judgment,” consideration of all criteria would require the use of overly complex approaches.

***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 interest should be accreted on the margin. However, per our response to Question 31, we disagree with the presentation of revenue as currently defined.

***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 that the remaining margin should be immediately recognized in net income under such circumstances. We are particularly concerned with situations where the amount by which expected cash inflows exceeds expected cash outflows erodes over several years. The Exposure Draft would require the entire remaining margin be recognized in net income in the one year where expected cash outflows eventually exceed expected cash inflows. This results in the timing of the margin recognition being disconnected from the timing of the events which caused the difference between the expected cash inflows and the expected cash outflows to erode.

We prefer that the margin be released over time as adverse experience emerges rather than to release the entire remaining margin all at once. See our response to Question 13 which provides further support for our preference that the margin be unlocked.

**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 believe that the proposed approach is an improvement over current accounting, as users of the financial statements have found the retrospective adjustments to deferred acquisition costs that arise under current accounting principles difficult to understand. However, we believe it more appropriate for acquisition costs to be included in fulfillment cash flows. Including these costs in fulfillment cash flows would provide a more faithful representation of the “margin” under the building blocks approach.

**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 approach. The complex and formulaic nature of the presentation of insurance contract revenue and incurred expenses make it likely to be confusing to users. We believe that users’ desire volume information and the proposed amounts presented may be confused with traditionally presented amounts. For example, insurance contract revenue, which represents an allocation of revenue across periods, may be inadvertently used as a volume metric for business sold during the period. In addition, significant system and process changes would be required to comply with the proposed presentation. Given the concerns already expressed, the costs associated with these changes, which are not insubstantial, would certainly exceed the value they provide.

We believe that revenue should be more reflective of the cash flows under the contract, which would be more reflective of the economics of the business. As an alternative, we would support the model being proposed by the ACLI.

In addition, the retrospective application and restatement for the earned premium at adoption would be very problematic.

**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 with the proposed approach for presenting revenue. Excluding amounts related to those an entity is obligated to pay regardless of whether an insured event occurs will add significant complexity to the calculation requirements while providing limited value to financial statement users. The amount and timing of the amounts to be excluded will need to be determined at the point that an entity issues an insurance contract and then likely be adjusted for each reporting period as expectations change as to when these excluded amounts will be repaid. We would expect a significant increase in the cost and complexity, particularly as it relates to retaining necessary data and estimating the amount of cash surrender value to be returned. Consideration should be given to current U.S. GAAP, where the deposit elements of certain contracts (e.g., universal life and annuity) are separately presented. We view this as less complicated than what has been proposed.

**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:**

We do not agree with the recognition of a loss on the acquisition date when the asset and liability balances related to insurance contracts measured in accordance with the proposed guidance exceeds the fair value of those assets and liabilities. We believe that the current practice of establishing an amortizable intangible asset for the difference is a preferable approach. We also believe this should be the case for portfolio transfers as well since recognizing a loss in connection with an arms length transaction seems inappropriate. If the FASB does not agree with this recommendation, we would be in favor of an adjustment to goodwill, consistent with the proposed approach of the IASB, rather than the recognition of a loss at the acquisition date.

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

**Response:**

Overall, we do not agree with the presentation requirements included in the proposals (see our response to Question 31). In addition, we believe the proposed gross presentation for income generated from the assets in qualifying separate account arrangements and the interest credited to those contract holders as a pass-through of that income is an unnecessary complication and makes it more difficult for users to analyze the Company's investment income that is not being passed through. We recommend that the current presentation requirements be retained, where the investment performance of separate accounts is offset against the corresponding amounts credited to contract holders in the same line item in the statement of profit or loss.

In addition, we do not see the benefit of separately presenting insurance contract portfolios in an asset position separately from portfolios in a liability position. In the vast majority of instances contracts move from an asset position to a liability position as a result of the payments of premiums due. This fluctuation will need to be explained and is more of an unnecessary distraction to users than it is useful information. Separate presentation also makes the required roll forward of the balances more difficult to prepare and explain to users. Additionally, we believe the current GAAP single line reporting on the statement of financial position for both segregated fund assets and liabilities should be continued as disaggregation provides no beneficial information to users.

**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:**

While we recognize the Boards goal of improving transparency through disclosure, an excess amount of disclosure can reduce transparency and result in less effective communication to users of the financial statements. We are concerned that the volume and depth of the proposed disclosures is so overwhelming as to compromise their usefulness to financial statement users, and inhibit their ability to understand what is important in evaluating the financial statements. Additionally, these requirements may lead to the disclosure of proprietary information, particularly as it relates to qualitative information on risk exposure and risk management techniques and methodologies.

Throughout the extended period of development for the measurement model, disclosures were added that were reactive to the particular aspect being discussed at that time. Now that the measurement model has been refined, a comprehensive review of disclosures needs to be conducted and a determination reached regarding what information is truly needed by users, what formats are most accessible to them and what might be excessive.

Please see the ACLI comment letter for recommendations, however we suggest that the Boards continue to seek input from all constituents with respect to disclosures before finalizing the requirements.

***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:**

The proposed insurance standard would be a fundamental change to our current practices and implementing those changes, including their retrospective applications to insurance contracts in-force at the transition date, will be an exceptional challenge.

There are systems and process implications that need to be considered and addressed, including updates from third party software vendors that will be needed before the related actuarial models can be developed to produce financial information and to support the extensive disclosure requirements.

Models will need to be built and field tested, and will likely require source data that is not currently captured or which may need to be reconfigured to provide what is needed.

Dry runs will need to be performed to gain a level of comfort that the changes are working and the results makes sense and can be understood and explained.

Areas beyond the financial statements will also be impacted and will need to be updated. Product development and pricing will need to contemplate the changes. Asset liability management programs will need to be reconsidered. Internal management reporting and incentive compensation will need to be retooled to work with the new measurement model.

A significant amount of time will be needed to appropriately implement changes of this magnitude. When you also consider the other major accounting change projects currently in their final phases, like financial instruments and leasing, the effort is really beyond anything we have done in recent memory. However, considering our experience with the adoption of U.S. GAAP, and other comprehensive implementations of Solvency II and the adoption of IFRS in Europe, which, on average, took 3 to 4 years to implement, and discussions with our software vendors, we would anticipate needing at least 5 years to implement the final standard, given its scope and scale.

**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:**

We agree with the proposed approach to transition and acknowledge it represents an improvement over the approach suggested in the 2010 Discussion Paper. We believe that the practical expedients are critical to our ability to apply the standard retrospectively given the size of our in-force business, the age of many of those contracts and the difficulties anticipated in obtaining the data needed to perform a full retrospective application.

However, we would like to point out that a number of respondents, including Prudential, are recommending that the margin be subject to the unlocking approach favored by the IASB. When the margin is subject more broadly to unlocking, much of the difficulty associated with measuring the margin at transition is mitigated because the use of current transition date assumptions become more important to the margin estimate than historical assumptions, which would reduce the complexity of transition. In addition, the IASB allows the use of hindsight in establishing cash flows prior to the transition date. This would further reduce complexity and FASB should consider this whether or not our suggestion of unlocking is accepted.

We would also like to note that we expect the determination of revenue for historical periods using the new presentation approach outlined in the ED to be especially complex if historical assumptions are required without providing much, if any, benefit to users.

**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:**

We expect to need 5+ years. Associated costs can be broken into three buckets. The three buckets are people, process and sustainability.

- People:
  - o Large stress on actuarial and finance/accounting resources during the implementation timeframe and beyond.
  - o Additional resources will need to be added during the implementation and transition time and until the actual impact on the actuarial and finance groups is determined; it is difficult to determine if these incremental additions are going to be permanent.
  - o Stress on resources will be significant based on current work-loads and the potential new step of work that will be required to prepare for and implement the standard.

- Globally, concerns exist as to whether adequate actuarial, accounting and systems resources are available to support implementation.
- Process:
  - The new processes will need to be designed and built based on the outcome of the standard. This will require us to wait for the ultimate guidance and could impact the timeline to implement. Processes need to be re-designed to fulfill the standard, have adequate controls and need to be tested and audited.
  - Automation efforts of the new processes will take a significant investment, which we conservatively estimate could well exceed nine figures. Actuarial models, financial and accounting systems and legacy insurance systems will be impacted and the work required will be significant. In addition, dual operations will be needed for the transition period putting more stress on people as mentioned above.
  - Financial disclosures and reporting will be significantly impacted, requiring a re-design of current processes. Again, this will require a duplication of processing during the implementation and transition periods causing additional stress on the business and people.
- Sustainability:
  - With the need for additional resources and the additional strain on the business processes required for implementation and transition, sustainability will be an issue. From both a People and Process perspective, having to do dual processing for a significant period of time will cause stress on the business, actuarial and accounting resources and systems.
  - Processes can be modified with significant efforts, but to automate those processes will take time, effort and testing. The People executing the new processes will be under time and resource pressure to complete all the necessary work to meet the requirements of the standard while those processes are being automated.

Note that changes to the earned premium approach, margin unlocking and the addition of more practical expedients for transition, e.g., determination of discount rates, would significantly mitigate the time and associated costs of adopting the proposed guidance.