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February 18, 2016

Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116
Via email to director@fasb.org

RE: *Fair Value Measurement (Topic 820) Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement* Exposure Draft

Dear Technical Director Cospers,

On behalf of the American Academy of Actuaries'¹ Financial Reporting Committee, I appreciate the opportunity to provide feedback on two issues in the Financial Accounting Standards Board's (FASB) Proposed Accounting Standards Update *Fair Value Measurement (Topic 820) Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*.

Question 5 states:

The proposed amendments to paragraph 820-10-50-2(bbb) require that a reporting entity disclose the weighted average of significant unobservable inputs used in Level 3 fair value measurements. Are there classes of financial instruments for which this disclosure is inoperable or does not provide meaningful information? If yes, please describe those classes of financial instruments and explain why.

In response to Question 5, there are certain guarantees commonly offered within insurance contracts for which the weighted average of significant unobservable inputs required by paragraph 820-10-50-2 (bbb) could be inoperable. Many guaranteed minimum benefits on variable annuities, such as guaranteed minimum accumulation benefits and guaranteed minimum withdrawal benefits, are embedded derivatives under existing U.S. generally accepted accounting principles (GAAP). Further, as part of FASB's project to implement targeted improvements to the accounting of long-duration insurance contracts, FASB has tentatively decided to report other

¹ The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

similar guarantees (e.g., guaranteed minimum death benefits and guaranteed minimum income benefits) at fair value.²

A typical approach to calculating the fair value of a variable annuity guarantee involves projecting the guarantee cash flows under many stochastic economic scenarios for many years. The average cash flows over the stochastic scenarios are then discounted back to the valuation date. The number of scenarios varies, but using 1,000 or more scenarios is not uncommon.

The cash flow projection involves a number of actuarial assumptions, such as mortality, surrender, and benefit utilization rates. These rates may vary for each policyholder, for each year of the projection, and even by scenario when dynamic policyholder behaviors are modeled.

Mortality, for example, may be 0.1 percent for one policyholder in the first year of the projection, growing to 0.11 percent the following year and ultimately to 100 percent by the end of the projection. An older policyholder may have an initial mortality assumption of 0.3 percent.

Lapse and utilization rates also are likely to vary over time by scenario. For example, under a scenario in which equity prices and/or interest rates decline, the surrender assumption may be 1 percent in year 5 and 2 percent in year 10. Under a scenario in which equity rates and/or interest rates increase, the surrender assumption may be 5 percent and 7 percent in years 5 and 10, respectively. In addition, the projected cash flow amounts and the present value of the cash flow amounts, which would be the most relevant basis for a weighted average, vary each year under each scenario for each policyholder.

A weighted average of these actuarial assumptions for a cohort of contracts may require averaging millions of data points and, as a result, will not be meaningful when calculated. The expense required to alter valuation systems to capture the necessary information will not result in useful information for investors.

Also, the weighted average disclosure does not take into account that assumptions may be interrelated. For example, even if the entity came up with an average surrender rate of 5 percent and an average utilization rate of 2 percent, it is possible that these values could never occur together at any point in the valuation, which further limits the value of using weighted averages. Instead, we recommend that the existing disclosure of ranges of values be enhanced to require a narrative description of the actuarial assumptions used, which should be specific enough to be useful to financial statement readers but not so specific that it would reveal proprietary pricing information. This disclosure could include a discussion of how the assumptions interact with each other.

Even if the existing disclosure of a range of possible values were enhanced with more description, there are situations where a more limited range of values would be more useful to readers of financial statements. Therefore, entities should have flexibility to disclose less than the full range of possible values if doing so would make the disclosed range more meaningful. As an example, the mortality assumptions used in a variable annuity guarantee fair value could range

² ["Insurance Project—Targeted Improvements to the Accounting for Long-Duration Contracts"](#)

from a small number for young policyholders early in the projection up to 100 percent for policyholders that reach the end of the mortality table (e.g., at age 100) at some point during the projection. As another example, lapse assumptions could include the impact of capital market sensitive lapses under rare economic conditions that may occur under a single scenario for a limited period of time, and thus have minimal effect on the fair value itself.

It would be more helpful to users if the disclosed range could be limited, at least in the primary disclosure table, to exclude such values that have minimal impact on the valuation. The limited range should be accompanied by explanation that allows users to understand that certain values were excluded and why. In considering this recommendation, the board would need to ensure that this is not an arbitrary range (e.g., the range from the 20th to the 80th percentile), because it is often extremely difficult to determine the percentile associated with a particular value.

We assume that the disclosures covered by this proposed accounting standards update would not be required for initial calculations of fair value pursuant to purchase GAAP, because purchase GAAP would represent initial recognition. However, if these disclosures are required for fair value calculations performed pursuant to purchase GAAP, our concerns about variable guarantees would extend to most insurance contracts, including life, health, and property & casualty insurance contracts. One alternative could be to scope out fair value calculations of insurance contracts from these disclosures, and provide for insurance contract fair value disclosures in a manner tailored to insurance contracts within Topic 944. This scope out also could apply to disclosures of variable annuity guarantees if and when the board adopts the current tentative decision to report variable contract guarantees with other-than-nominal capital market risk at fair value within Topic 944 as part of the insurance contract targeted improvements.

We also would like to support the proposed changes to paragraph 820-10-50-2 (g). Describing the disclosure in terms of “uncertainty” rather than “sensitivity” is an important improvement. This wording better reflects the intent of the disclosure—emphasizing uncertainty as of the measurement date rather than how the calculation might vary in the future.

Thank you for the opportunity to provide feedback to the FASB on its exposure draft regarding changes to the disclosure requirements for fair value measurement. If you have any questions or would like to discuss these issues in more detail, please contact Nikhail Nigam, the Academy’s policy analyst for risk management and financial reporting, at 202-785-7851 or nigam@actuary.org.

Sincerely,

Leonard Reback, MAAA, FSA
Chairperson, Financial Reporting Committee
Risk Management and Financial Reporting Council
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