



Michael Monahan
Senior Director, Accounting Policy

February 29, 2016

Ms. Susan Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7, P. O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, Fair Value Measurement (*Topic 820*): *Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement, File Reference No. 2015-350* (“the Proposed Update”)

Dear Ms. Cospers:

The American Council of Life Insurers (ACLI)¹ welcomes the opportunity to comment on this important matter. We fully support the Financial Accounting Standards Board’s (Board’s) disclosure framework project, the primary purpose of which is to improve the effectiveness of disclosures in the notes to the financial statements by facilitating clear communication of the information required by generally accepted accounting principles (GAAP) that is most important to users of a reporting entity’s financial statements.

ACLI supports the proposed elimination of certain disclosures either because they are not consistent with the concepts in the proposed FASB Concepts Statement, Conceptual Framework for Financial Reporting – Chapter 8: Notes to Financial Statements (Proposed Concepts Statement) or because they are no longer deemed to provide useful information. However, ACLI questions the decision-usefulness of certain of the proposed modifications to existing disclosures, or the underlying disclosures themselves, while noting the significant costs that would be required to produce them; namely,

- 1) The disclosure of weighted averages of significant unobservable inputs (“Level 3”) for derivatives, including derivatives embedded in insurance products and insurance benefits measured at fair value, is not decision-useful and would be extremely costly to prepare,
- 2) The disclosure of time periods used to develop Level 3 inputs is not generally applicable because the input is a current estimate and not a value calculated from data of a historical period, or if calculated from a historical period, such data is not readily available or obtainable for distinct variables, and

¹ The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. Learn more at www.acli.com.

- 3) The Level 3 rollforward and proposed additional disclosure of unrealized gains and losses for Level 1 and 2 instruments held at the end of the period (as well as existing for Level 3) should be eliminated because the disclosures do not satisfy a clear objective, are not decision-useful, and are costly to prepare.

In the attachment to this letter, ACLI has expanded upon these key points by providing responses to the questions included in the Proposed Update.

ACLI appreciates the opportunity to offer comments and perspective on these important matters and welcomes further dialogue. Please feel free to contact ACLI (MikeMonahan@acli.com; 202-624-2324) if ACLI can be of service to the Board during future work on this project.

Sincerely,

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

Michael Monahan
Senior Director, Accounting Policy

Attachment

Questions from Proposed ASU, Topic 820 – Changes to the Disclosure Requirements for Fair Value Measurement

Question 1: Would the proposed amendments result in more effective, decision-useful information about fair value measurements? If not, please explain why. Would the proposed amendments result in the elimination of decision-useful information about fair value measurements? If yes, please explain why.

The proposed amendments would not result in more effective, decision-useful information about fair value measurement. See ACLI responses to question 5 (weighted average of significant unobservable inputs) and question 6 (time period used to develop significant unobservable inputs) for new disclosures that do not result in more effective and decision-useful information about fair value measurement.

See ACLI response to question 8 for where the Proposed Update does not go far enough in eliminating disclosures (Level 3 rollforward and the change in unrealized gains and losses for financial instruments held at the end of the year) that do not provide cost effective decision-useful information about fair value measurements.

Additionally, for investments in certain entities that calculate net asset value, a modification in the Proposed Update limits the disclosure requirement of the timing of liquidation of an investee's assets, and the date when restrictions from redemption will lapse, only to those investments where the investee has communicated the timing to the entity or announced the timing publicly. Although the ACLI agrees with the limitation that has been proposed, we do not agree that retaining the requirement to communicate the timing of liquidation is aligned with the proposed Concept statement (i.e., as mentioned in the Basis for Conclusions, it does not describe an input for investments measured at net asset value using the practical expedient). It also is "forward looking" in nature and should not be in the notes to the financial statements and therefore should be eliminated in all circumstances.

Question 2: Are the proposed disclosure requirements operable and auditable? If not, which aspects pose operability or auditability issues and why?

ACLI notes that not all of these requirements are currently operable (see ACLI response to question 5 on weighted averages).

Question 3: Would any of the proposed disclosures impose significant incremental costs? If so, please describe the nature and extent of the additional costs.

Also noted in the ACLI response to question 5 (weighted average of significant unobservable inputs), the Proposed Update's new disclosures would impose unreasonable incremental costs given the lack of benefit of providing such data. In order to calculate weighted averages for ACLI member product derivatives, many ACLI member companies would need to program complex model changes, run the model across thousands of scenarios, test and review the data, and implement control procedures over these new requirements. These costs would be in the form of employee hours, diverted resources, programming changes, computer processing time and management review and oversight. By several ACLI member estimates at least one year would be needed to program and test model changes necessary to disclose weighted averages. The weighted averages are not decision-useful so the cost is not justified.

Question 4A: The proposed amendments would apply to all entities, except for certain requirements in paragraph 820-10-50-2(bbb) through (d), for which private companies would be exempt. Do you agree with the exemption for private companies? If not, please describe why and which disclosures should be required for private companies.

Our proposal to eliminate certain disclosures (i.e., Level 3 rollforward and the change in unrealized gains and losses for financial instruments held at the end of the year), including those where the Proposed Update would only exclude private companies, should apply to all entities as they do not provide decision-useful information in a cost effective manner.

Question 4B: Should entities other than public business entities (for example, employee benefit plans and not-for-profit organizations) also be exempt from the proposed amendments mentioned in Question 4A? If yes, please describe why and which disclosures they should be exempt from.

Our proposal to eliminate certain disclosures (i.e., Level 3 rollforward and the change in unrealized gains and losses for financial instruments held at the end of the year), including those where the Proposed Update would only exclude private companies, should apply to all entities as they do not provide decision-useful information in a cost effective manner. Should the board not agree with our proposal, at a minimum, employee benefit plans should be exempt from having to disclose the Level 3 rollforward and the proposed disclosures. These are costly disclosures and do not provide meaningful information to the users of employee benefit plan financial statements.

Question 5: 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.

There are classes of financial instruments for which this disclosure is inoperable (or cost prohibitive) or does not provide meaningful information.

For freestanding derivatives significant unobservable inputs often include interest rate volatility and equity volatility. Providing weighted averages would not be decision-useful considering the various potential bases for weighting. Notional amount and fair value amount weightings would be distortive and not meaningful because they do not reflect tenor or other instrument terms. For example a 1-year \$100 million notional swap would be weighted the same as a \$100 million 10-year swap. As another example, a deep-in-the-money put option that is close to expiration will have a large fair value, but the valuation of that option is largely insensitive to volatility. Weighting by fair value results in that option's volatility having a distortive impact to the overall weighted average, despite the fact that the volatility assumption isn't material for that option. ACLI considered other weighting bases that could convey sensitivity to the input such as duration for interest rate or Vega for optionality but these high-level math concepts are overly complex for general purpose financial statements. Therefore, ACLI concludes only the range of unobservable inputs is useful for disclosure for derivative contracts. If the range itself is so large (i.e., 0 - 100%) to not provide meaningful disclosure, ACLI recommends keeping this disclosure as is; specifically, continue to allow the appropriate exercise of discretion by reporting entities to provide situational information that is relevant. Rather than requiring boiler plate disclosures, such discretion is consistent with one of the objectives of improving the effectiveness of the notes to the financial statements.

For derivatives embedded in insurance contracts, such as guaranteed living benefits, reinsurance GMIBs, and other indexed products, significant unobservable inputs often include withdrawal

utilization, withdrawal rates, lapse rates, mortality, reset elections and equity volatility. Like for freestanding derivatives, providing weighted averages would not be decision-useful considering the various potential bases for weighting. ACLI provides the following additional rationale:

- Reported fair values are based on thousands (or more) of long-term (e.g., 40 year) projection scenarios, during which time the values of many of the unobservable inputs are projected as changing. The projected values of unobservable inputs depend on capital market level paths, interest rate curve points across time, persons' ages across time, etc. Therefore, providing a weighted average of a dynamic unobservable input would be incrementally distortive and non-decision useful for product derivatives.
- Other possible bases for weighting unobservable inputs for product derivatives include base contract account value, net amount at risk, policy count and insurance benefit value. Insurers would select from the various bases we identified in this letter or more bases, thus further degrading the usefulness of the information by a lack of comparability across insurance industry reporting.
- Because the fair valuation of a particular product derivative, such as guaranteed minimum withdrawal benefit policy riders, is dependent on multiple unobservable inputs (e.g., withdrawal utilization, withdrawal rates, lapse rates, mortality, reset elections and equity volatility), the disclosure of a weighted average for each input involved in a product derivative valuation will not yield useful information as to the overall valuation of the product derivative, or how the valuation would be impacted by different weighted averages.

The Proposed Update's new disclosures would also impose unreasonable incremental costs given the lack of benefit of providing such data. In order to calculate weighted averages for ACLI member product derivatives, many would need to program complex model changes, run the model across thousands of scenarios, test and review the data, and implement control procedures over these new requirements. These costs would be in the form of employee hours, diverted resources, programming changes, computer processing time and management review and oversight. By several ACLI member estimates, at least one year would be needed to program and test model changes necessary to disclose weighted averages. The weighted averages are not decision-useful so the cost is not justified. ACLI further notes that the product derivatives that are required to be bifurcated and measured at fair value, are expected to grow in number as the Board has tentatively decided that all such benefits are to be reported at fair value as part of efforts to pursue incremental improvements to the accounting for long duration insurance products.

Question 6: The proposed amendments to paragraph 820-10-50-2(bbb) require that a reporting entity disclose the time period used to develop significant unobservable inputs. What would be the costs associated with including this disclosure? Would this disclosure provide more effective, decision-useful information?

Time periods used to develop Level 3 inputs are generally not applicable or are not meaningful because the input is a current estimate and not a value explicitly calculated from data of a distinct historical period and time period data is generally not readily available or obtainable for distinct variables. Level 3 fair values include securities, freestanding derivatives and embedded derivatives, such as guaranteed living benefits. ACLI notes that insurers do not rely solely on historical data over a specific time period to develop inputs. Generally, insurers use a combination of market observable data, historical data, and applied judgment.

For securities and freestanding derivatives examples could be:

- Prepayment rates are observable for a number of years, but assumptions are set with greater weight placed on recent years and judgment applied to reflect the current interest rate market outlook; and
- Implied volatility, which is directly market observable for shorter tenors, but requires use of judgment and other market data points to construct inputs for longer tenors.

For product derivatives, insurers analyze historical experience data over a number of years, but when setting assumptions, generally place more credibility on the most recent years, and may also make adjustments for specific circumstances or market conditions that we believe might make the historical data less representative of future expected behavior.

For these reasons, the proposed requirement to disclose the time period used to develop significant unobservable inputs would not be applicable. To the extent entities disclosed a historical period that they observed and then applied judgment to weight and otherwise adjust, ACLI believes the disclosed period could be potentially misleading. Therefore ACLI recommends the Board does not include a required time period disclosure in any amendments to the fair value disclosures in ASC 820. Rather, ACLI recommends keeping this disclosure as is; specifically, continue to allow the appropriate exercise of discretion by reporting entities consistent with one of the objectives of improving the effectiveness of the notes to the financial statements.

Question 7: Are there any other disclosures that should be required by Topic 820 on the basis of the proposed Concepts Statement or for other reasons? Please explain why.

Users of financial statements already have a vast mosaic of information about the fair value of financial instruments and this information should continue to be scrutinized so that only information that is essential, cost-effective and decision-useful is required to be provided.

Question 8: Are there any other disclosure requirements retained following the review of Topic 820 that should be removed on the basis of the proposed Concepts Statement or for other reasons? Please explain why. To see how the Board applied the decision questions from the proposed Concepts Statement to Topic 820, see *Decision Questions Considered in Establishing Disclosure Requirements*.

The Level 3 rollforward and proposed addition of the change in unrealized gains and losses for Level 1 and 2 financial instruments held at the end of the period should be eliminated because they do not satisfy a clear disclosure objective, are not decision-useful and are costly to prepare. Additionally, there is significant diversity in practice, such as with the definition of purchases and settlements, when categorizing a period's activity in the rollforward. This significant diversity in practices further contributes to the non-decision-useful nature of the rollforward disclosures.

The Level 3 rollforward reconciliation requirement does not meet the objectives of the FASB's own Proposed Concepts Statement on disclosures because the rollforward information does not rise to the threshold of being "most important to users of each entity's financial statements." ACLI understands that users indicated to the Board that the Level 3 rollforward "...allows them to gain insight into management's decisions, especially across different economic cycles" and the change in unrealized gains and losses "provides information about the volatility of fair value measurements." However, ACLI members saw no evidence of this in interaction with financial statement users and ACLI requests a better understanding of these insights given the significant cost and time expended every reporting quarter in preparing the detailed Level 3 rollforward and the change in unrealized gains and losses. Users have a vast mosaic of information about financial instruments at fair value, including robust descriptions of valuation methodologies, disclosures that break down fair values by classes, and then

classes by fair value hierarchy level, and we encourage the Board to take stock of the information disclosed about financial instruments in its totality.

If Level 3 rollforward is retained, ACLI strongly recommends not adopting the proposal to add the disclosure for changes in unrealized gains and losses for Level 1 and 2 financial instruments. For many member companies, aggregating Level 3 information requires manual processes which would be significantly increased with this change. The benefits of the additional disclosures being proposed do not exceed the time, effort and expense that will be incurred to comply and the disclosures will not improve the quality of financial reporting.

Question 9: How much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by nonpublic business entities be different from the amount of time needed by public business entities? Should early adoption be permitted? If yes to either question, please explain why.

If the Proposed Update were adopted as written, an implementation period of at least a full year would be appropriate to allow for the requisite programming changes, computer processing time and management review and oversight. As noted in our response to questions 5 (weighted average of significant unobservable inputs) and 6 (time period used to develop significant unobservable inputs), some of the new proposed disclosures are complicated and would require significant systems work and/or review. ACLI again reiterates, however, that the Proposed Update includes additional disclosures with significant incremental costs that do not provide decision-useful information