Financial Security...for Life.

Mike Monahan
Senior Director, Accounting Policy

November 22, 2016

Ms. Susan Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: Exposure Draft: File Reference No. 2016-340 – Premium Amortization on Purchased Callable Debt Securities

The American Council of Life Insurers[1] ("ACLI" or "we") appreciates the opportunity to comment on the FASB Proposed Accounting Standards Update – Premium Amortization on Purchased Callable Debt Securities ("proposed ASU" or "exposure draft"). The ACLI supports the FASB's proposed changes in the exposure draft to require accelerated amortization of premiums on callable bonds, while retaining existing accretion of discounts to maturity date. While the FASB is proposing to amortize premiums to first call date, the ACLI is more supportive of amortizing premiums by applying the yield-to-worst ("YTW") methodology that considers fixed call prices (not always equivalent to amortization to first call date) as, consistent with the FASB's comments in the exposure draft, the YTW method that considers fixed call prices is generally used to quote, price, and trade callable debt securities. As a result, applying YTW that considers fixed call prices would be more consistent with how investors view callable bonds.

Although ACLI is supportive of the exposure draft, we have additional recommendations to clarify the guidance to ensure more consistent application by financial statement preparers. Our comments regarding the exposure draft can be summarized as follows:

ACLI supports the YTW that considers fixed call prices and not simply yield to first call date:

Although many bonds are callable at par on a particular call date, a significant number of bonds have various call dates and fixed call prices ("call tables"). The YTW methodology widely used by investors considers contractual call tables when identifying to which call date and call price a bond premium is to be amortized in order to recognize the worst yield. It does not ignore that a bond would be called at a

[1] The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 280 member companies operating in the United States and abroad. ACLI advocates in state, federal, 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 95 percent of industry assets, 92 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Learn more at www.acli.com.

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fixed price different than par. The proposed ASU would amortize any premium over par to the first call date and therefore would produce ***the absolute worst yield***. To amortize a premium to the call date that produces the worst yield without considering the call price on the call date would be inconsistent with how the market views YTW and is inconsistent with the contractual provisions of a bond. That is, a borrower would not be able to call a bond on a call date at a price other than the fixed call price. Amortizing a bond to a contractual call date and fixed call price applying YTW still ensures a loss is not recognized for any remaining unamortized premium if the bond is called and also ensures that any gains are minimized.

We note that, if the proposed yield to first call date methodology was adopted, it could produce results that are not meaningful. There could be understated yields before the first call date and a gain at call. Under certain circumstances, the methodology to amortize to first call date may produce a negative yield for a bond if the amortization of the premium exceeds the coupon. Such a result could be inconsistent with the bond's expected economic return.

As insurance companies, regulatory reporting (NAIC Statutory Reporting) requires premiums to be amortized by applying the YTW method that considers fixed call prices. Applying the same method on a U.S. GAAP basis would better align to our statutory basis of accounting.

Premiums to be amortized should be all-inclusive:

The proposed ASU includes in the scope securities purchased at a premium as discussed in ASC 310-20-35-33. Although most premiums are generated at the time a bond is purchased, premiums may also be generated from discontinued hedging relationships (i.e., basis adjustments from marking to market the hedged risk), from business combinations, bond modifications, capitalized fees, etc. We believe all such premiums (amortized cost in excess of par) should be amortized by applying the YTW method that considers fixed call prices.

The term "callable" should exclude make-whole provisions:

ACLI assumes the scope of the proposed ASU includes all debt securities that have call dates with pre-set contractual call prices, and that the scope excludes debt securities that have only make-whole provisions. The YTW methodology widely used by investors typically disregards make-whole provisions. Make-whole provisions are calculated using a formula (e.g., Treasury rates plus 50 basis points) to determine the prepayment amount if a bond is prepaid in advance of maturity date. Conceptually, the make-whole formula compensates the investor for lost future income from investor reinvestment risk (i.e., the risk that the investor will reinvest the proceeds from a prepaid bond at a lower interest rate). Amounts paid upon prepayment of a bond as a result of a make-whole are thus unknown in advance (does not facilitate application of the YTW methodology) and change on-going based on, for example, Treasury rates. Additionally, make-wholes may occur at any time (not a pre-set date) and thus are not predictable. As a result of the unknown aspects involving make-wholes, ACLI believes debt securities with only make-whole provisions (i.e., do not have pre-set call prices and call dates) should be excluded from the scope of the ASU and the premiums should continue to be amortized to maturity. It would be helpful for the FASB to clarify this in the final ASU.

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Please also see the attached Appendix, which contains the questions to which the FASB requested responses.

We appreciate the FASB considering the ACLI views on this matter. Please contact me if you have any questions or comments.

Sincerely,

Mike Monahan
Senior Director, Accounting Policy

Appendix:

Question 1: Do you agree that the premiums on purchased callable debt securities should be amortized to the earliest call date? Please explain why or why not.

We agree that premiums (including basis adjustments from discontinued hedges, business combinations, purchase of bonds, etc.) should be amortized in a more accelerated way than to maturity. However, we do not agree that yield to first call date is the appropriate methodology as it is inconsistent with how callable bonds are priced and traded, and does not consider the fact that some bonds have contractual call prices that are other than par. Yield to worst (YTW) that considers all call dates and fixed call prices is more reflective of the economics of a bond and is how callable bonds are priced and traded. As mentioned in our cover letter, yield to first call date may not produce the same result as YTW depending on facts and circumstances. Insurers are also supportive of YTW that considers fixed call prices, consistent with insurance regulatory requirements.

Question 2: How much time would be needed to implement the proposed amendments? Should entities other than public business entities be provided more time? Should early adoption be permitted?

If the YTW method that factors in fixed call prices was adopted, some insurers may be able to leverage existing regulatory reporting when adopting the proposed ASU. However, should the FASB decide to adopt yield to first call date, we believe more time would be needed to test systems and analyze results, including life insurer investment spreads (i.e., yields on investments versus crediting rates on various policies). If yield to first call date were adopted, we would request two years to adopt the new standard.

Early adoption should be permitted.

Question 3: Do you agree with the proposed transition method and disclosures in paragraph 310-20-65-1 (c)? Please explain why or why not.

ACLI agrees with the transition method of a cumulative effect adjustment to retained earnings as to prospectively adjust a bond for the proposed ASU may result in significant impacts to investment spreads reported in the future. As an example, if upon adoption, a bond has a call date that is fast approaching, significant amounts of premiums may be required to be amortized in order to apply the YTW or yield to first call date methodology. This may impact investment spreads significantly in the near term and be misleading to a financial statement user.

We also agree with the disclosure of a change in accounting principle if deemed material.