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December 19, 2017

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116
Submitted via email to: acasas@fasb.org

RE: Definition of Market Risk Benefits in *Proposed Accounting Standards Update: Financial Services – Insurance (Topic 944) Targeted Improvements to the Accounting for Long-Duration Contracts*

Dear Technical Director Cosper,

On behalf of the American Academy of Actuaries'[1] Financial Reporting Committee, I would like to share with you the results of an open-ended survey we conducted among the members of the project team that prepared our 2016 comment letter on the exposure draft about the definition of market risk benefits as it was shown to the Financial Accounting Standards Board ("the Board") at its November 1 meeting.

Since this new concept (market risk benefits) will be significant to many insurers, we believe clarity of the definition to be vital in implementing the board's intention. We believe that seeking broad input now, before the definition is written into the final Accounting Standards Update (ASU), may help to ensure that the changes do meet that intention.

The attached survey results represent independent interpretations of the individuals who contributed to the survey, and do not necessarily express or reflect the opinions of their employers. In addition, they do not represent the official statements or opinions of the American Academy of Actuaries or any of its boards, committees or practice councils. The Academy has not reviewed or approved the survey responses. Other than context (such as the significance of the definition's position within Topic 944), we did not give any direction in this survey on how to interpret the definition. Nor did we do anything to change the results for different interpretations. Where we present conflicting interpretations, it's because different people came to different conclusions.

[1] The American Academy of Actuaries is a 19,000-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 policy makers 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.

We would be glad to discuss this issue further with the FASB, perhaps exploring ways to strengthen the definition or to effectively communicate its intent through implementation guidance or other means.

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Thank you for the opportunity to provide feedback to the FASB on the definition of market risk benefits. 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,

Steven Malerich, MAAA, FSA
Vice-Chairperson, Financial Reporting Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries

Market Risk Benefits Survey Results

Question 1:

Describe here any contracts and contract features considered but excluded because they are not subject to Topic 944 (Insurance).

Response 1:

Financial instruments in general

Response 2:

Term certain immediate annuities

Response 3:

GMXB wrappers on standalone mutual funds without insurance features (say a pure GMWB) would seem to be a standalone derivative and thus would never be within scope of 944. Similarly, stable value wrappers on separate account guaranteed investment contracts (GIC) seem to be standalone derivatives. In any case, these would still be fair valued, albeit with non-performance risk changes in net income.

Question 2:

Describe here any contracts and contract features considered but excluded because they are subject to insurance standards other than those applicable to deposit contracts.

Response 1:

Whole life insurance and associated paid-up additions

Response 2:

Term and traditional life insurance contracts

Response 3:

Possibly a stable value feature in a synthetic GIC. The GIC is presumably an investment contract and probably uses FAS 91-like accounting, but as an investment contract covered by 944 not sure if the FAS 91 accounting approach would cause those features to be scoped out. Reinsurance of MRBs seems to not be an MRB because there is generally no account balance in the reinsurance. Hence it would be necessary to include language to avoid accounting mismatches that if an MRB is reinsured, the reinsured benefits are considered MRBs, regardless of the form of the reinsurance (I think there was language like this in the 2016 ED). DIG B36 features on modified coinsurance or funds withheld reinsurance do not seem to be considered MRBs because it is not based on an account balance. But it would still be an embedded derivative reported at fair value, albeit with non-performance risk changes in net income.

Question 3:

Describe here any features that you believe would be MRBs under the proposed standard. (Briefly explain your rationale.)

Response 1:

Variable annuities with guaranteed minimum accumulation, death, income or withdrawal benefits (GMxBs)—guarantees subject insurer to market risk as level of benefit is fixed or a fixed schedule of increase and account balance and associated fees are subject to market movement. Contract feature protects policyholder from adverse capital market performance (there is some debate whether the criteria that the "account balance" is the item that is protected with GMxBs).

Variable universal life policies with guaranteed minimum death or living benefits—same rationale and concerns as in variable annuities with GMxBs.

Fixed Indexed Annuities Index Feature—exposes insurer to capital market risk as needs to pay participation in equity performance, and the feature causes variability in account balance based on market performance.

Fixed Indexed Annuities with GMxBs—same rationale as with VA and VUL.

Universal Life with secondary no lapse guarantees—exposes insurer to market risk through minimum assumed interest rate embedded in pricing and protects account balance or similar amount from adverse capital market performance. Similar amount might be effect of account balance going to zero.

Response 2:

GMxB, perhaps excluding GMDB (depending on the likelihood of death causing an other-than nominal cost).

Response 3:

Guaranteed minimum withdrawal benefit on variable annuity—exposes the entity to significant capital market risk arising from a contract feature that protects the amount available for periodic withdrawal from adverse capital market performance.

Guaranteed minimum death benefit on variable annuity—exposes the entity to significant capital market risk arising from a contract feature that protects the amount available upon death from adverse capital market performance.

Guaranteed minimum income benefit on variable annuity—exposes the entity to significant capital market risk arising from a contract feature that protects the amount available for annuitization from adverse capital market performance.

Guaranteed minimum accumulation benefit on variable annuity—exposes the entity to significant capital market risk arising from a contract feature that protects the account value from adverse capital market performance.

Guaranteed minimum withdrawal benefit on any type of equity indexed annuity—exposes the entity to significant capital market risk arising from a contract feature that protects the amount available for periodic withdrawal from adverse capital market performance.

Equity indexed contract that credits negative equity index returns and provides a guaranteed minimum nonforfeiture value—exposes the entity to significant capital market risk arising from a contract feature that protects the account value from adverse capital performance.

Guaranteed minimum death benefit on variable universal life contracts—exposes the entity to significant capital market risk arising from a contract feature that protects the amount available upon death from adverse capital market performance.

Response 4:

The tax benefit rider on VAs could potentially qualify for MRB. Previously the definition only covered downside risks, but now are expanded to include market volatility (upside and downside). The tax benefit rider (sometimes called enhanced earnings benefit) pays additional amount to cover the taxes the policyholder are subject to pay from earnings in the variable annuities. If a contract owner dies and the account value is the death benefit, the beneficiary will have tax liability. If the policy experienced positive returns (upside) and AV is greater than deposit, such a rider will be utilized to pay taxes, which exposes the VA insurer to risks.

Response 5:

All VDA GMDB GMIB GMAB GMWB

VUL w/ secondary guarantee

Total Return Annuity with segregated portfolio and unit values that change daily

FIA (w&w/o GMWB)

Indexed UL

Fixed DA with Market Value Adjustment

Response 6:

GMXBs on variable annuities and index features of EIA and EIUL seem to be included. GMXB wrappers (such as LWB) on standalone mutual funds could be or contain MRBs assuming they get accounted for under FAS 97.

Some Japanese contracts have premium and death benefits in JPY but the account balance is stated in USD. Although the stated account balance does not fluctuate with FX changes (since it is always stated in USD), it gets paid out on surrender at the current JPY rate so effectively there is FX risk inherent in the account balance. (On the other hand it could also be argued that this is a surrender value feature and thus not the "account balance" itself and so out of scope for MRB unless the surrender value is deemed to be a "similar amount.")

Other features that MAY fall here may include:

- Variable life no-lapse guarantees (shield the policyholder from the effect of account balance going to zero, in substance similar to guaranteeing that the account balance will not be less than the COI charge amount on the COI incurral date),
- The existence of a separate account (depends on whether that is deemed to subject the insurer to other than nominal capital market risk; it meets the criteria for presumption even though the separate account is legally shielded),
- A market value adjustment (technically that works of the cash value rather than the account balance, but a cash value could be considered a "similar amount"" and in some cases the cash value before the MVA may equal the account balance). Though the MVA is theoretically designed to shield the insurer from risk of interest rate movements on early termination assuming the insurer holds appropriate assets, on its own terms the MVA causes variability in cash flows due to interest rate movements.

Response 7:

Variable annuities with GMIB/GMAB/GMWB benefits. Fixed Index Annuities and Fixed Index UL. Is this intended? Meaning that traditionally, FIA's & FIUL's would have valued the ED elements to capture the Market Risk Benefits. Will they now be valued differently and if so, how? Does the whole contract now get valued as a whole as a MRB or just the MRB piece of it as added onto the Account Value?

Under element a, would UL with Secondary Guarantees be considered a contract feature that protects the account balance from adverse capital market performance (due to a lower interest rate environment than assumed at issue). In other words the account can never go below zero.

What about Payout options under the above products that have an equity linked component. I.e. the choice is to elect each year, ahead of time to get a fixed interest, say 2 percent or to take a percent of the S&P so the rate may be 0 percent to say 10 percent? The original contract is under the deposit method accounting and the payout stream is traditionally included in that block as opposed to being considered a separate FAS 91 product. So these are benefits with no AV, but are subject to the same market risks as the underlying accumulation credits.

Question 4:

Describe here any features considered and subject to evaluation under the MRB definition but which you believe are not MRBs. (Briefly explain your rationale.)

Response 1:

Variable Annuity base contract pass through feature—no market risk retained by insurer. Assumes presumption of market risk can be overcome.

Variable Life base contract—same rationale as VA base.

Response 2:

Guaranteed minimum interest crediting rates on fixed annuities—exposes the entity to significant capital market risk but not arising from a feature that protects the account balance or causes variability in the account balance. The term “protects the account balance” is interpreted to mean protects from loss of account value.

Equity indexed contract that does not credit negative equity index returns and provides a guaranteed minimum nonforfeiture value—exposes the entity to significant capital market risk but not arising from a feature that protects the account balance or causes variability in the account balance. The term “protects the account balance” is interpreted to mean protects from loss of account value.

Universal life contracts—exposes the entity to significant capital market risk but not arising from a feature that protects the account balance or causes variability in the account balance. The term “protects the account balance” is interpreted to mean protects from loss of account value.

Variable annuity base contract—does not expose the entity to significant capital market risk.

Variable universal life base contract—does not expose the entity to significant capital market risk.

Response 3:

Deferred annuity annuitization options (separate contract)

Basic UL (I would distinguish between CM emergence and CM volatility. Crediting rates might be 4 or they might be 2, but it’s because of emergence of interest rate, not because of volatility in bond prices.)

FDA w&w/o GMWB (Again CM emergence, not volatility; a buy and hold strategy's credited rates won't be effected by daily changes in market values)

401(k) Just hold Customer Account Balance which is effectively already at fair value.

403(b) Just hold Customer Account Balance which is effectively already at fair value.

VUL w/o Secondary guarantee Just hold Customer Account Balance which is effectively already at fair value. ("Market Risk" is de minimis in that the risk is recovery of DAC only, which may be offset by URL.)

Response 4:

General account discretionary interest credits (even though the credited rate will move due to capital market interest rate changes, the insurer still has discretion to keep the rates constant, and this discretion presumably scopes the feature out of MRB—an example making this explicit would probably be helpful though). For similar reasons, a minimum interest guarantee, a minimum annuitization rate guarantee or a secondary guarantee on a non-indexed general account UL contract do not appear to be MRBs, since insurer discretion comes between the capital market movement and the risk from those guarantees. The secondary guarantee may also be excluded on the basis that it is protecting the death benefit rather than the account balance, but I think there are counterarguments to that in that the guarantee still protects against the consequences of a zero account balance. I don't think a separate account M&E fee would be a market risk benefit because although it exposes the insurer to capital market risk (the insurer collects more or less fees depending how the separate account assets perform), it is hard to see it as "protecting" the account balance or causing variability in the account balance, although if you squint hard enough you can make it fit (e.g., it "protects" the account balance to the extent that if the separate account declines the insurer bears some of the burden thus partially "protecting" the account balance from the full impact).