Financial Security...for Life.

Mike Monahan
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Mr. Russell Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Effects of Tax Reform re ASC Topic 740

Dear Mr. Golden:

The American Council of Life Insurers (ACLI)[1] would like to express concerns related to the interaction of tax reform and certain requirements in Accounting Standards Codification Topic 740, Income Taxes (ASC 740). It is becoming clear that tax reform will soon become a reality and U.S. taxpayers will need to quickly address all the accounting and reporting challenges associated with changes in tax laws and a reduction of the U.S. corporate tax rate beginning in 2018.

The FASB recently received a letter from the American Bankers Association (ABA) requesting a technical correction related to applying ASC 740-10-15. This guidance requires the impact of a change in tax rate on all deferred tax assets and liabilities (DTAs and DTLs) be recorded through income from continuing operations even if the original deferred tax item was established through accumulated other comprehensive income (AOCI). This leaves the tax impact or DTAs and DTLs established through AOCI and existing in the period of enactment at the historical corporate tax rate of 35% while the deferred tax impact of future changes related to those items will subsequently be recorded through AOCI at the newly enacted rate. The result is a blended measurement of AOCI DTAs and DTLs in the equity section of the balance sheet.

The current expected reduction in the corporate tax rate is significant and will have a material impact on much of the country's financial statements. While all industries will face challenges associated with recording and disclosing the implementation of tax reform, the ACLI believes that the challenges presented by current guidance with respect to AOCI will result in financial statement balances that will be significantly misleading and confusing to the financial statement users amplified by the magnitude of investments carried at fair value in AOCI in the banking and insurance industries.

[1] The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 290 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, 93 percent of life insurance premiums, and 98 percent of annuity considerations in the United States. Learn more at www.acli.com.

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For perspective, the life insurance industry holds approximately $3 trillion of investment grade bonds; a significant amount of those assets are classified as available for sale and carried at fair value by recording unrealized gains and losses net of deferred tax in AOCI. The two methods of tracking the subsequent mismatch, resulting in a blended tax rate in AOCI is on a by security level (not common) and a portfolio level (most common). When considering portfolios of the size typically carried by a bank or insurer, tracking the changes in deferred taxes in AOCI at the different tax rates by individual security would be extremely burdensome. Conversely, when the portfolio method is chosen it is almost a certainty that the rate differential will remain a permanent reconciling item in AOCI. It is generally understood that once a method is chosen, an accounting method change would be required to convert. Some ACLI member companies with foreign and multi-state operations already have mismatched items in AOCI that have not required an insurmountable amount of work to track and have followed the individual level tracking method without considering the overwhelming burden of continuing this practice with a potential future significant impact related to a change in U.S. federal tax rates. Compounding the complexity of individual tracking, insurers have additional items in AOCI that offset the after-tax unrealized gains and losses in AOCI related to available for sale securities. These additional items include shadow deferred acquisitions, shadow value of business acquired, and shadow reserve for future policy benefits; each item affects a compilation of different types of securities for which an offsetting adjustment will need to be tracked. Some of these programs and portfolios are managed outside the company which will require significant coordination and effort to track and maintain in the future.

A letter submitted by the American Bankers Association to the FASB requested consideration of immediately adopting backward tracing principles into ASC 740. ACLI agrees in principle with this request, but proposes another alternative that could be more quickly codified and implemented without affecting prior period income statement results:

1. Provide an automatic accounting method change implementable January 1, 2018 from a “by security” tracking approach to a “portfolio level” tracking approach to limit the undue burden on some companies going forward

2. Provide transition guidance applicable in 2018 that would allow a reclassification of amounts between AOCI and retained earnings to eliminate the mismatch between the historical tax rate and the newly enacted tax rate, i.e., the amount of tax lodged in AOCI representing the difference between the historical and newly enacted tax rates. This transition guidance should apply to all previous changes, not just current tax reform, thereby resetting ending AOCI balances to reflect current enacted tax rates.

We believe there is precedent for a re-class between AOCI and retained earnings in the transition guidance associated with ASU 2016-01 Financial Instruments - Recognition and Measurement.

This is an unprecedented time in U.S. tax history, and the magnitude of the “dangling debits and credits” that will remain in AOCI due to a significant reduction in the U.S. corporate tax rate requires immediate modification and clarification in the accounting guidance on the part of the FASB. Such modification and clarification would result in a significant reduction in cost and effort for preparers and their auditors over a time period commensurate with final maturity of investments held when the new tax rate was enacted. It also will result in increased understanding for financial statement users of the AOCI effective tax rate for U.S operations reported at the enacted tax rate and with less complicated effective tax rate disclosures and reconciliations.

In summary, we request the above specific two actions to immediately address the mismatch and, in addition, ACLI would support a future project to carefully analyze and vet the pros and cons of backward tracing. We believe addressing the two items mentioned above would significantly improve the meaningfulness of AOCI to financial statement users post-tax reform, and minimize undue burden on financial statement preparers and auditors.

We appreciate your consideration of our concerns on this matter, and welcome your feedback on our comments.

Sincerely,

Mike Monahan
Senior Director, Accounting Policy

Copy to Members of FASB