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February 28, 2018

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

Dear Technical Director Cosper,

The American Council of Life Insurers (ACLI)[1] appreciates the opportunity to provide additional comments on the FASB Exposure Draft (ED) – Financial Services-Insurance (Topic 944) *Targeted Improvements to the Accounting for Long-Duration Contracts* specifically with respect to the amortization of unearned revenue liabilities (URL) on universal life-type contracts.

Under Topic 944 as it exists today, paragraph 944-605-35-2 mandates that URL is amortized "using the same assumptions and factors" used to amortize deferred acquisition costs (DAC). This mandate is not changing under the ED proposals. However, a key element of DAC amortization guidance is changing under the updated ED proposals. Paragraph 944-30-30-2 is amended to state that "acquisition costs shall not be amortized before incurrence of those costs, including future contract renewal costs." Such a restriction would be problematic if applied to URL amortization of front-end fees and other amounts assessed that represent compensation to the insurance entity in advance of future services (herein referred to simply as "front-end fees").

It is common for front-end fees on universal life-type contracts to be charged for an extended period of time. Front-end fees extending for 20 years or more are not uncommon. Restricting URL amortization to only the front-end fees that have been charged in the past without regard for the fees that will be contractually charged in the future as long as the contract remains in force would distort the pattern of revenue recognition. Too little revenue would be recognized in the early years of the contract and too much revenue would be recognized in the later years.

This can be illustrated using a simplified example. Assume a contract is expected to remain in force for 50 years and charges front-end fees of $10 per year for each of the first 20 years. Assume for simplicity that DAC and URL are amortized straight line over the 50-year expected life of the contract. In year 1 only

[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 policyholders 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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10/50 = $0.20 would be amortized into revenue. It is not until year 20 that the ultimate amount of a little over $5 per year would begin to be amortized into revenue.

A more conceptually sound approach would amortize 200/50 = $4 into revenue each year, assuming no interest is accreted. As long as the policy remains in force for at least 20 years, the insurer will collect $200 of front-end fees in accordance with the terms of the contract. So, the $0.20 of revenue that would be recognized in year 1 dramatically understates the amount of revenue the insurer earned in that year. The slightly higher revenue recognized in each of the next few years would also be significantly below the amount of revenue the insurer actually has earned. If the contract terminates before the 20-year fee collection period, the insurer would collect less revenue for front-end fees but would also be relieved of providing insurance services for the full 50-year contract period. In that case, $0.20 of revenue recognized in year 1 and the slightly higher revenue amounts in the next few years would still be significantly below the amount of revenue the insurer would have earned in those years.

We can see two possible fixes to address this issue. One possible fix would be to permit future front-end fees to be recognized for amortizing URL, even if that is inconsistent with the amortization used for DAC and certain other assets. This approach would allow for a more conceptually sound revenue recognition pattern while still aligning with the FASB's decision to simplify amortization of DAC and similar balances.

Another possible fix would be to delink URL amortization from DAC amortization and instead amortize URL in proportion to insurance inforce using a methodology consistent with deferred profit liabilities (DPL) on limited-payment contracts. This could be justified since a front-end fee is conceptually similar to the loading(s) on a limited-payment contract. In both cases the policyholder makes a payment for services over a shorter period than that over which the services are provided. FASB seems to recognize this similarity in that both DPL and URL amortization are addressed within section 944-605. If URL were amortized using an approach consistent with DPL, as illustrated above, the amount of revenue recognized would not be exactly $4 per year, but the difference would be a result of interest accretion, which is appropriate by analogy to interest accretion on DPL.

The URL calculation under this approach should differ from the current ED approach to DPL calculations in that the DPL calculation unlocks assumptions retrospectively to be consistent with the liability for future benefits on limited payment contracts. Since the URL is an accrual of fees collected in the past, a prospective unlocking approach would be more appropriate. This would be a very simple difference to reflect in the standard.

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Thank you for your consideration of our comments herein. If you have any questions or would like for us to meet on this, please let us know.

Sincerely,

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Mike Monahan
Senior Director, Accounting Policy

cc: Alex Casas, Senior Project Manager

APPENDIX – Possible Wording Suggestions

Approach 1 (URL amortization consistent with DAC except for recognition of future front-end fees)
If FASB agrees with the first approach to addressing this issue (retaining URL amortization consistent with DAC but allow the amortization ratio to reflect future expected front-end fees), paragraph 944-605-35-2 could be amended as follows:

Amounts recognized as unearned revenue under paragraph 944-605-25-6 shall be recognized in income over the period benefited using the same assumptions and factors used to amortize capitalized acquisition costs under the Long-Duration Contracts Subsection of Section 944-30-35-3C, except that amounts expected to be assessed in the future shall be included in the determination of amortization of unearned revenue.

Approach 2 (URL amortization consistent with DPL amortization)
If FASB agrees with the second approach to addressing this issue (i.e., amortizing URL consistent with DPL), paragraph 944-605-35-2 could be amended as follows:

Amounts recognized as unearned revenue under paragraph 944-605-25-6 shall be recognized in income over the period benefited using the same methodology used to amortize the deferred profit liability in paragraph 944-605-35-1A.

Paragraph 944-605-35-2A could then be added to state:

The balance of unearned revenue shall be adjusted proportionally for actual insurance in force deviating from expected insurance in force (that is, as a result of deviations in contract terminations). The effect of changes in future estimates (for example, revisions in mortality of lapse assumptions) shall be recognized in those future periods on a prospective basis as a change in accounting estimate in accordance with paragraph 250-10-45-17.

FASB may consider alternative approaches to deal with experience deviations and assumption changes; for example the additional paragraph 944-605-35-2A could be based on paragraph 944-605-35-1B amended to address changes in termination assumptions rather than cash flow assumptions. However, paragraph 944-605-35-1B uses a retrospective unlocking approach consistent with the liability for future benefits, which seems particularly inappropriate for a URL which is based on past fund flows.

FASB may also consider using the contract rate to discount the URL instead of the rate described in paragraph 944-40-30-9, which is referenced by paragraph 944-605-35-1A, since the contract rate is used for other universal life-type liabilities.