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Russell G. Golden, Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Financial Services - Insurance (Topic 944) *Targeted Improvements to the Accounting for Long-Duration Contracts* (ED) – Effective Date Decision at June 6, 2018 Meeting

Prudential Financial, Inc. (the "Company" or "Prudential") would like to take the opportunity to express our concerns on the Board's recent decision regarding the effective date for *Targeted Improvements to the Accounting for Long-Duration Contracts*. We believe the Board's decision to require a January 1, 2021 effective date for public business entities, which is effectively just over 2 years to implement, is not realistic and we strongly urge the Board to reconsider this decision prior to issuance of the final standard and provide companies at least one more year to properly implement the new standard.

As a company with a broad array of product offerings and numerous domestic and international operations, we rely on a variety of customized and product-focused vendor systems and home-grown applications to calculate these balances. **At a minimum, we will need 3 years (33 to 42 months) to adequately implement, integrate and test the changes into these systems as outlined below.**

Vendor development and implementation of system changes	15-18 months
Integration of updated systems into production environment	9-12 months
Testing and validation of changes	9-12 months
Total timeline	33-42 months

The critical path needed to meet implementation will require a sequential timeline, with little opportunities to perform these tasks simultaneously. The above three phases are described further below.

1. <u>Vendor development and implementation of system changes:</u> One of our software vendors (one of the leading actuarial software vendors in the industry) has given us preliminary estimates that the system changes (summarized below) will take about **15 to 18 months** to develop and implement once the final standard is published, not including any customization for Prudential products, which will require additional time. We have several instances today of customized modeling capabilities for vendor systems reflecting the breadth and complexity of our products and businesses. We will need to work with the vendors to understand the approaches, options, and timeline to carry through the customization once the final standard is published. System modifications necessary include:

a. Develop capabilities to track and retain the additional history and data needed to retrospectively update cash flows, recalculate the net premium ratio and deferred profit liability amortization percentage to reflect actual experience and updated future assumptions for non-participating traditional insurance contracts.

b. Develop capabilities to perform two quarterly reserve calculations for non-participating traditional insurance contracts (i.e. one calculation using the locked-in interest rate and another calculation using current interest rates).

c. Develop a new framework and models to calculate the fair value of our compound market risk benefits. While our variable annuity living benefit guarantees are accounted for today at fair value, our guaranteed minimum death benefit guarantees (GMDBs) are accounted for today under an insurance accrual model. Since most variable annuity contracts contain a GMDB feature, in addition to a living benefit guarantee, we will need to make significant changes to our valuation processes to bundle those guarantees together as a single compound market risk benefit. Additionally, due to a lack of historical data, several judgments and simplifying assumptions will need to be made to estimate historical information for the required retrospective adoption.

d. Change DAC models for all products to reflect amortization on a constant basis over the expected life of the contract and create new DAC models for products where we did not have DAC before (such as single premium payout annuities). This will also result in changes to other amortization models by analogy (deferred sales inducements, unearned revenue reserves, value of business acquired) and secondary processes (recoverability and profits followed by losses testing).

e. Develop the new quantitative disclosure requirements.

2. <u>Integration of updated systems into production environment:</u> Once we receive the vendor system changes, we will then need to integrate the changes from the vendor systems into Prudential's financial reporting system infrastructure to meet downstream reporting needs, which include modifying the input processes, the creation of new capabilities to address disclosure requirements and ledger processing. These changes will take about **9 to 12 months.** Note, these changes would be occurring in parallel with other recent state insurance regulatory changes that impact our reserve calculations which have already constrained our IT resources (e.g. principles-based reserving (PBR) approach, AG43 reform, etc.).

3. <u>Testing and validation of changes:</u> With all the changes mentioned above, we will need to perform extensive testing and validation of the results in order to comply with Sarbanes-Oxley and our company-specific internal controls and governance standards to avoid errors or unintended consequences. We will also need to perform production parallels, restatement of balances including roll-forwards, and impact analysis to prepare for production implementation. This will take about **9 to 12 months**. In addition, our external auditors will need sufficient time to perform their procedures necessary to render an opinion on the financial statements and internal control over financial reporting.

Additional challenges that will further impact the timeline include:

- An effective date of January 1, 2021 will require restated financial statements on the same accounting basis as of January 1, 2019 for comparative reporting purposes. Assuming the final standard is published in late August 2018, that would leave companies with just 4 months to assess the impact to downstream reporting processes to determine what data will need to be stored beginning January 1, 2019. This will be a highly impracticable task given the need to address interpretative and transition issues as described below.

- Despite some simplifications included in these changes, insurance accounting is still very complex. Ample time will be needed to thoroughly review the language in the final standard once issued, and to develop, test and document internal policies and methodologies. This may take considerable time for aspects of the proposal that are principles-based (i.e. market risk benefits, discount rate definition) and for aspects of the transition that are problematic (retrospective transition for market risk benefits). Time will be needed to work through such interpretative and transition issues with industry groups, such as the ACLI, and audit firms.

- Given that there has been limited, if any, field testing of the key provisions expected in the final standard, ample time will be needed to identify and resolve any issues that are uncovered during the testing and development phase. Preparers, along with the actuarial and auditing communities, will need sufficient time to identify and resolve all implementation issues that will undoubtedly arise as we research and estimate the significant impact these changes are expected to have on our balance sheet at transition and income statements going forward.

- Once the implementation issues are addressed, it will take a considerable amount of time to properly educate (a) company personnel from the C-Suite down to the staff level, (b) rating agencies, (c) analysts, (d) regulators and other financial statement users of the expected impact, which will most likely include, for public entities, a complete analysis of potential changes to management reporting bases (i.e. segment income statement reporting measures). Additionally, the secondary impacts of these changes will create additional “BAU” type work as many companies will likely revisit their current investment and hedging strategies, product designs, debt covenants, etc., putting a strain on existing resources.

- Software vendors have not been able to formally commit to a timeframe for modifying their systems in the absence of a final standard, and in some cases, will not begin work until they receive business requirements for the changes, which will require additional time. We are concerned that software vendors might reach their max capacity to support various companies’ requests at the same time to make any changes in a timely manner. Any delay by vendors in providing systems capable of handling the robust calculations required by the new guidance increases the risks of being unable to fully implement, test and integrate the changes into our reporting processes and would impact the timeline above. The Board may wish to consider performing outreach to software vendors for feedback on their implementation plans and timelines.

- Our international business, which is comprised of local operations in 13 countries, represents a significant portion of our total business, and a significant portion of this business is non-participating traditional insurance products. We currently have a vast degree of customization and variation for actuarial systems and reporting processes amongst the various operations to accommodate both local reporting and US GAAP reporting. Additionally, many products sold in international businesses differ from typical US products, often requiring additional interpretations and system customizations to accommodate US GAAP. This makes it particularly challenging to implement Targeted Improvements simultaneously with IFRS 17 which is also effective January 1, 2021, especially given that the new accounting standards are significantly different.

- We anticipate that the implementation effort will require a significant increase in actuarial and IT staff. Given the specialized skill sets that will be required and the high level of demand in the market, we have concerns regarding the feasibility of hiring and training the necessary staff within the time allotted. Consulting resources with specialized insurance accounting knowledge are already scarce and will not be able to meet the high demand that will undoubtedly arise in the industry.

This new standard represents the most significant and impactful change to accounting guidance the insurance industry has ever implemented and merits adequate time to implement to ensure it results in high quality financial statements. Targeted improvements is essentially the insurance industry's version of Revenue Recognition (i.e., changes the fundamental accounting model for our business) and should be expected to require, at a minimum, a similar amount of time to implement (i.e. 3 ½ year implementation period). As such, we respectfully request the Board to reconsider the effective date and change the effective date for public companies to fiscal years, and interim periods within those fiscal years, beginning after December 15, 2021.

We appreciate your consideration of our comments. If you would like to discuss, please contact Candace Woods at (973) 802-7898 or Rob Axel at (973) 802-3555.

Sincerely,

Candace J. Woods

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