Session 041 PD - Update and Impacts of FASB Targeted Improvements

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Update and Impacts of FASB Targeted Improvements

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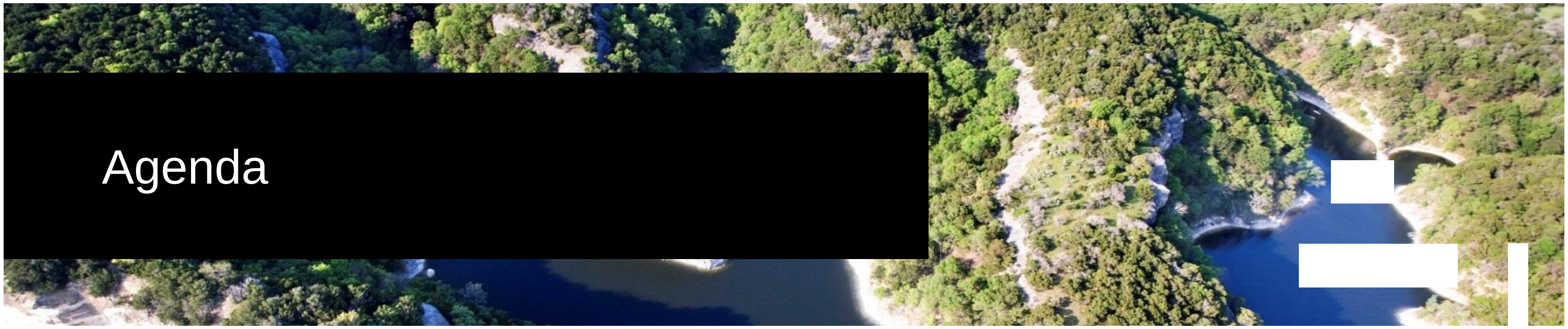

Agenda

- Overview
- Summary of Proposed Changes and Industry Reactions
  - Benefit Liabilities – Traditional Long-Duration Contracts
  - Benefit Liabilities – Participating Contracts
  - Deferred Acquisition Costs
  - Market Risk Benefits
- Summary

Background

2002 – 2013

FASB pursued a converged international accounting standard with IASB

2014

Additional disclosures around short-duration contracts

More substantial changes to accounting for long-duration contracts

Current status

Developments over last year

2016 September	2016 December	2017 Spring	Late 2017/ Early 2018
Released a proposed Accounting Standards Update to Topic 944	Solicited comments on the draft standard	Reviewed the comments and hosted a roundtable discussion	Appears final standard will be issued

- Comment letters were generally supportive of the FASB's decision to pursue targeted improvements
- Respondents generally suggested a minimum 3-year transition period
- The FASB met on August 2, 2017 to redeliberate the liability for future policy benefits for non-participating contracts and again on October 4 to redeliberate participating contracts, DAC and market risk benefits

Benefit liabilities – traditional long-duration contracts

Proposed changes

Formerly locked-in assumptions will be updated (at least) annually

Updated cash flow assumptions applied retrospectively, discount rate assumptions applied immediately

- Updated cash flow assumptions to be reflected in net income
- Updated discount rate to be reflected in Accumulated Other Comprehensive Income

Cash flow assumptions to be best estimate (with no provisions for adverse deviation)

Discount rate to be based on an observable “high quality” fixed income instrument yield

Benefit liabilities – traditional long-duration contracts

Industry reaction (per comment letters)

- Responses were generally favorable around the concept of unlocking benefit liabilities

- Nearly all responses believed a retrospective application of assumption updates was more costly than beneficial

- Respondents were generally in favor of an observable discount rate, though most objected to the use of a “high quality” (assumed to be equivalent to AA-rated) fixed income reference

- At the August 2 meeting, the FASB tentatively decided on an “upper-medium” (assumed equal to A-rated) grade fixed income yield and allowing transition at current liability carrying values

Benefit liabilities – participating contracts

Proposed changes

Same proposed benefit liability discount rate (high quality fixed income) as traditional contracts

Benefit liabilities – participating contracts

Industry reaction (per comment letters)

- Nearly all comment letters that addressed participating contracts objected to the use of a discount rate other than what was used to set dividends

- The FASB states that the investor community is generally supportive of the proposed change

- Most comment letters suggested a simplified treatment (such as using supporting assets as in Canada) to calculate the benefit reserves associated with closed blocks

- At the October 4 meeting, the FASB tentatively decided to retain existing measurement guidance for liabilities (but apply proposed DAC amortization changes)

Deferred acquisition costs

Proposed changes

Amortization of deferred acquisition costs (“DAC”) on all long-duration contracts (except investment contracts using the interest method) will be over the expected life of the book of business and in proportion to insurance in force (or another measure if insurance in force can’t be reasonably estimated)

Interest would not accrue on DAC balances

Exempting DAC from loss recognition testing is proposed as well

Deferred acquisition costs

Industry reaction (per comment letters)

- Most respondents supported the idea of simplifying DAC amortization and most believed insurance in force was a reasonable amortization driver

- Responses were split on eliminating recoverability/loss recognition testing on DAC

- At least one response indicated the change in amortization could misalign expense recognition with the other economics of insurance products

- Many responses noted a lack of clarity around other items that are amortized in a similar manner to DAC (net reinsurance cost, VOBA, unearned revenue liabilities, etc.)

- At the October 4 meeting, the FASB tentatively decided to update the proposed amortization basis to a “constant basis over the expected life of the contract” and that DAC should be written off for actual experience in excess of expected experience, without considering contract profitability
- They also decided that transition guidance should be consistent with benefit liabilities

Market risk benefits

Proposed changes

All GM*B types within variable annuities would be classified as market risk benefits and held at fair value

Fair value changes resulting from instrument-specific credit risk would be reported in Accumulated Other Comprehensive Income, instead of operating earnings

Market risk benefits

Industry reaction (per comment letters)

- Nearly all responses indicated agreement with the idea that market risk benefits should be held at fair value

- A significant number of letters commented that guaranteed minimum death benefits should not be classified as market risk benefits

- Several comments were also made noting that economically similar benefits in non-variable products would have different accounting treatment

- At the October 4 meeting, the FASB tentatively decided to expand the scope of market risk benefits to include general account deposit contracts such as Fixed Indexed Annuities

Summary

- A final standard appears likely in late 2017 or early 2018
- The FASB announced at the October 4 meeting that the following topics will be discussed at future meetings
  - Presentation and disclosures
  - Effective date
- Based on feedback, a 3-4-year transition will put the first reporting period at 2021-2022
- Generally, changes such as unlocking traditional assumptions are intended to better align asset and liability reporting
- Simplifying DAC amortization will generally accelerate expense recognition and remove the DAC “offset” to current period earnings fluctuations

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