FASB FINANCIAL ACCOUNTING STANDARDS BOARD

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Memorandum

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Project	**Insurance Contracts**
Topic	**Comment Letter and Other Feedback Summary**

Background

1. On June 27, 2013, the Financial Accounting Standards Board (FASB) issued proposed Accounting Standards Update, *Insurance Contracts (Topic 834)*. The main objective of the guidance in the proposed Update is to increase the decision usefulness of the information about a reporting entity's insurance liabilities, including the nature, amount, timing, and uncertainty of cash flows related to those liabilities, and the effect on the statement of comprehensive income, and to provide comparability, regardless of the type of entity issuing the contract.

2. The comment period for the proposed Update ended on October 25, 2013. As of January 2, 2013, 207 comment letters were received. The table below provides information on the types of comment letter respondents:

Type of Respondent	Number of Respondents
Preparers	150
Users	12
Auditors/accounting firms	6
Professional organizations	18
Regulators and government agencies	8
Individuals	9
Others	4
Total Respondents	**207**

3. The preparers category includes 19 life insurers, 75 property and casualty insurers, 2 health insurers, 6 reinsurers, 18 other insurers, and 30 noninsurance entities.

4. The Board and FASB staff also conducted field testing with 18 preparers to gather feedback on the operationality of the guidance in the proposed Update. During field testing, insurance entities were asked to apply the requirements of the proposed Update to a subset of portfolios and noninsurance entities were asked to review existing contracts to identify whether they would be in the scope of the guidance in the proposed Update. The table below provides information on the types of field testing participants:

Type of Participant	Number of Participants
Life insurance	4
Property and casualty insurance	4
Health insurance	2
Reinsurance	2
Other/composite insurance	2
Noninsurance	4
Total Participants	**18**

5. The Board and the FASB staff also performed outreach with many U.S. and global buy-side and sell-side analysts in the life insurance and property and casualty insurance industries.

6. Additionally, the Board and the FASB staff held three public roundtable meetings, including two in Norwalk, Connecticut, which focused on issues specific to the building block approach and the premium allocation approach, and one in Rosemont, Illinois, that included topics related to the scope of the proposed Update and issues specific to nonpublic entities. Numerous other outreach meetings were held to discuss stakeholders' views on the guidance in the proposed Update, including discussion forums, group meetings, and individual meetings and calls.

Purpose

7. This memorandum provides a summary of the feedback received on the June 2013 proposed Update through comment letters, field testing, roundtable discussions, and other outreach. This memorandum is meant to be read together with memorandum number 110 that provides a summary of feedback received during outreach discussions with users.

Overall Feedback

8. A majority of respondents, roundtable participants, and field testing participants agree with the objectives of the guidance in the proposed Update to provide decision-useful information about a reporting entity's insurance contracts in its financial statements and to represent the economics of the transaction and improve comparability, regardless of the type of entity issuing or holding the contract. A significant number of preparers and auditors/accounting firms also stated that creating a single, high-quality global accounting and financial reporting standard is important and support convergence of U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), while most users noted that convergence of U.S. GAAP and IFRS is secondary to improving existing U.S. GAAP.

9. Many stakeholders who support convergence of U.S. GAAP and IFRS noted that it is essential to converge the following aspects of the amendments in the proposed Update with IFRS:

a. Definition of a portfolio

b. One-margin approach or two-margin approach

c. Types of cash flows that would be included in the measurement of fulfillment cash flows

d. Whether or not the margin should be adjusted for changes in fulfillment cash flows due to changes in assumptions (locking or unlocking the margin)

e. Presenting changes in discount rates in other comprehensive income (OCI) or in net income

f. Accounting for deferred acquisition costs

g. Accounting for participating contracts.

10. If those aspects of the proposed Update cannot be converged with IFRS, then those stakeholders support only targeted improvements to existing U.S. GAAP because, overall, the costs would outweigh the benefits of implementing the guidance in the proposed Update. Some respondents also were concerned that the guidance in the proposed Update would significantly diverge from U.S. statutory accounting principles, and users were concerned that historical information and previous analyses would be lost and that certain valuation metrics used would no longer be relevant. Property and casualty insurance preparers, users, and professional organizations strongly opposed changes to existing U.S. GAAP accounting for short-duration contracts, noting that existing guidance works well and is superior to the guidance in the proposed Update.

11. Some respondents generally agreed that certain aspects of the guidance in the proposed Update are an improvement to existing U.S. GAAP. For example, many respondents agreed that updating assumptions at each reporting period under the building block approach (BBA) is an improvement to existing U.S. GAAP. Those respondents stated that the BBA provides more transparency in recognizing expected losses than the stand-ready concept under Topic 944, Financial Services—Insurance. Certain respondents also supported the principle of measuring the cash inflows and outflows and recording an explicit margin, because

that would provide more relevant and useful information to financial statement users.

12. Many property and casualty insurance respondents supported including an undiscounted claims development table to provide users with information to better understand an insurer’s ability to properly underwrite and anticipate claims. In addition, some preparers stated that an undiscounted claims development table can be prepared without significant additional costs or complexity because it is currently prepared for statutory reporting purposes.
13. Further detail on those and other significant comments are provided below.

Scope

14. While many respondents generally agreed with the scope of the proposed Update, including its applicability to contracts written by noninsurance entities, many respondents disagreed. Most of the respondents that agreed were insurance entities, while most of the respondents that disagreed were noninsurance entities.
15. The respondents who agreed with the scope of the proposed Update noted that the guidance would resolve the diversity in practice in the accounting for similar contracts issued by different types of reporting entities. For example, respondents representing the perspective of financial guarantee insurance entities noted that currently, banks and insurance entities both issue financial guarantee contracts; however, banks account for those contracts under Topic 460, Guarantees, or Topic 815, Derivatives and Hedging, while insurance entities account for them under Topic 944. Including all entities that issue similar contracts within the scope of the proposed Update would resolve this diversity in accounting practice and would result in all of those contracts being accounted for in the same manner.
16. Some respondents who disagreed with the scope of the proposed Update noted that the scope of insurance contract accounting should be limited to entities subject to insurance regulation, since the inclusion of other entities would not promote consistency in financial reporting. One respondent recommended that the scope of the proposed Update should include the concept of “primary business purpose” to

determine whether the guidance should be applied to contracts issued by entities not regulated as insurance entities.

17. Many respondents who disagreed with the scope of the proposed Update had concerns about accounting for certain contracts that would meet the definition of insurance contracts. Some respondents who generally agreed with the scope of the proposed Update also had concerns about including certain contracts within the scope that already have existing guidance that properly accounts for the economics of those contracts. Specific concerns with the scope of the proposed Update are discussed below.

Fixed-Fee Service Contracts

18. Some respondents disagreed with the conditions in the proposed Update to exclude certain fixed-fee service contracts from the scope. For example, one respondent noted that customer-specific pricing in a service contract should not result in the classification of a contract as an insurance contract, while another respondent noted that an option to use third-party vendors to render services also should not result in a contract being accounted for as insurance. This respondent further noted that the criterion related to cash payments to a third-party service provider is inconsistent with the proposed guidance in Topic 605, Revenue Recognition, that requires reporting entities to not distinguish between an obligation to actually perform a service and an obligation to reimburse a third party to perform the service. Certain field testing participants also had similar concerns and noted that those conditions may result in different accounting for contracts with similar economic characteristics.

19. Health insurance entity respondents were concerned that the scope exclusion for certain fixed-fee service contracts could require similar capitation agreements to be accounted for differently. A few respondents noted that some health insurers administer the services being provided to the policyholders while others do not, which can lead to different treatment for similar capitation agreements. During other outreach performed, certain stakeholders recommended that the

implementation guidance for capitation agreements should be clarified, because the pricing may not always be at a fixed amount per person and the service provider does assume risk in those arrangements. Certain respondents suggested that capitation agreements offered by health insurance entities be excluded from the scope of the proposed Update to avoid having similar product offerings accounted for differently.

Catastrophe Bonds

20. Some respondents and field testing participants noted that catastrophe bonds should be excluded from the scope of the proposed Update and should continue to be accounted for at fair value. Those stakeholders noted that those financial instruments have readily available quoted market prices, and fair value measurement would result in a more objective and reliable value than a probability-weighted estimate that would be required by the guidance in the proposed Update.

Guarantees

21. Some respondents and certain field testing participants disagreed with including within the scope of the proposed Update guarantees in which the adverse future event is default. Those respondents recommended that default risk should be explicitly included in the definition of financial risk and, therefore, excluded from the scope of the proposed Update. Respondents noted that there is a difference between insurance risk, which is defined as being fortuitous and outside the control of the insured, and default risk, which is generally considered to be the likelihood of a borrower or counterparty failing to meet its contractual obligations. Default risk is not a fortuitous event since it can be actively managed over time by restructuring exposures or adjusting collateral maintenance requirements. The degree of cash flow uncertainty introduced by default risk is different than the fortuitousness of a car accident or untimely death and, therefore, respondents noted that contracts that expose issuers primarily to default risk should be excluded from

the scope of the proposed Update. A few respondents noted that including many of those guarantees within the scope of the proposed Update would unnecessarily introduce additional line items in the financial statements of reporting entities and would reduce the comparability with other noninsurance entities.

22. Many respondents and certain field testing participants noted that standby letters of credit should not meet the definition of an insurance contract because those transactions result in the recognition of an asset (loan receivable) on the issuing entity's balance sheet and are usually collateralized and, therefore, do not expose issuers to a significant risk of loss. Certain field testing participants and roundtable participants also noted that there did not seem to be material differences between the economics of standby letters of credit that would be considered insurance contracts and commercial letters of credit that would not be considered insurance contracts in the implementation guidance of the proposed Update.

23. Many respondents and certain field testing participants also disagreed with categorizing contractual representations, indemnifications, and warranties as insurance contracts. Those stakeholders generally noted that such contractual clauses are (a) incidental to larger transactions, (b) accounted for in the transaction pricing at contract inception, and (c) subsequently measured under the existing guidance of Topic 460. Some respondents noted that those contractual clauses should not meet the definition of insurance contracts since the purpose is to ensure that the issuer has satisfied its obligation to its customer as part of a larger transaction and the issuer is not compensated for including those clauses. Furthermore, the risk of incurring a significant loss as a result of those contractual clauses is remote.

24. Some respondents and field testing participants commented that guarantees related to trust preferred securities are, in substance, an indemnification of a reporting entity's own performance and therefore should be excluded from the scope of the proposed Update.

25. Finally, some respondents and certain field testing participants recommended that the guidance in the proposed Update include clarification or additional

implementation guidance for guarantees that are considered unusual and nonrecurring. Those stakeholders noted that the meaning of unusual and nonrecurring is unclear when guarantees are embedded in specific transactions such as business combinations, which would result in diversity in practice and issues with auditability.

Separating the Components of an Insurance Contract

26. A majority of the respondents generally agreed with the requirements included in the proposed Update about when noninsurance components of an insurance contract, including embedded derivatives, distinct investment components, and distinct performance obligations to provide goods or services, would be separately accounted for under other applicable Topics. Respondents stated that the proposed Update's guidance for unbundling investment components would provide additional transparency into a contract's insurance risk. Some respondents who generally agreed and the respondents who generally disagreed had certain concerns, which are discussed below.

Distinct Performance Obligation to Provide Goods or Services

27. Respondents were concerned that the requirement to unbundle obligations to provide goods and services provided in connection with insurance would be costly and would not be decision useful. Some respondents stated that it would not be appropriate to unbundle components of a contract in which the insurer has priced the contract as a whole and manages the contract as a single contract. Some respondents added that both conditions in paragraph 834-10-25-5 should be met for a performance obligation to be considered distinct.[1]

[1] Paragraph 834-10-25-5 of the proposed Update states that a performance obligation to provide a good or service is distinct if either of the following criteria is met: (a) the policyholder or its beneficiary can benefit from the good or service either on its own or together with other resources that are readily available to the policyholder or its beneficiary or (b) the entity's promise to transfer the good or service to the policyholder or its beneficiary is separable from the promises associated with the insurance component of the contract.

28. Many respondents recommended that the guidance in the proposed Update clarify whether or not claims administration services provided by health insurers are intended to be unbundled from the insurance contracts and accounted for separately. Certain respondents said that claim administration services should not be unbundled from the insurance contract because the service is not optional for the policyholders selecting that specific insurance contract. Respondents were unclear on whether or not claims administration services would be considered distinct if the customer has the ability to "opt out" of the services and perform the services themselves or use a third party for the services.

29. A few property and casualty insurance entity respondents also recommended that the guidance in the proposed Update should clarify whether loss prevention services would be required to be separated from the insurance contract. Those respondents noted that those services are ancillary and generally a critical part of ensuring that the underwriting of the policy is appropriate and that the policy is profitable. In addition, loss prevention services are generally a small component of the overall insurance contract, and bifurcating them would be costly and complex.

Distinct Investment Component

30. Many respondents generally agreed with the proposed Update's guidance on separation of distinct investment components. Some respondents, however, noted that the proposed Update does not provide clear guidance on whether asset management fees for life insurance contracts should be accounted for separately. Some respondents added that asset management fees should not be accounted for separately because they are an integral part of the insurance contracts. A few respondents noted that policyholder investments in separate accounts are similar to mutual funds but, due to a small level of insurance risk, the related fees and expenses would have very different accounting from the accounting for the fees received by a third-party asset management company performing the same services. Respondents noted that remeasuring management fees and expenses on a

quarterly basis would add volatility to financial statements and would not be decision useful for users.

31. Some respondents recommended that the guidance in the proposed Update should illustrate that a reporting entity should not separate the investment component of a whole life plan with a cash surrender value, since neither the insurance component nor the investment component can be measured independently without considering the other. Those respondents stated that the cash surrender value and insurance component are clearly and closely related and, therefore, should not be separated.

Embedded Derivative Component

32. Respondents generally agreed that the guidance in the proposed Update would appropriately limit the unbundling of embedded derivatives. However, some respondents added that the guidance would not adequately address the diversity in practice that exists today under existing U.S. GAAP with identifying embedded derivatives in certain life insurance contracts. For certain variable annuities with guaranteed minimum withdrawal benefits, a few respondents recommended that the guidance in the proposed Update should clarify how Subtopic 815-15, Derivatives and Hedging—Embedded Derivatives, should be applied to promote comparability and consistency across reporting entities. A few respondents also recommended that all variable annuity riders should be incorporated into the scope of the proposed Update to increase the consistency in the accounting and the transparency about changes in the estimated value of the rider guarantees.

33. Finally, some respondents noted that the proposed guidance on embedded derivatives would have an impact on reinsurance related to business ceded on a modified coinsurance basis. Under existing U.S. GAAP, reporting entities separate embedded derivatives from the rest of the agreement. Respondents are concerned that the guidance in the proposed Update would prohibit reporting entities from electing to account for the assets associated with underlying policies at fair value, which would result in an accounting mismatch, which, in turn, would result in financial statements that are confusing to users.

Measurement Approaches

One Model or Two Models

34. The majority of respondents agreed or generally agreed that entities should apply different approaches to contracts with different characteristics, described in the proposed Update as the BBA and the premium allocation approach (PAA). One respondent recommended that separate standards should be created for each of those two models. The respondents who generally agreed noted that although there should be two different models, the guidance in the proposed Update does not adequately describe the characteristics of a contract that should be measured using the PAA. Many respondents who generally agreed with having two separate models commented that U.S. GAAP is superior to the proposed PAA since it is time tested, is well understood by financial statement users and preparers, and properly represents the economics of the contracts in a reporting entity's financial statements.

35. Some respondents disagreed with the concept of two separate models. They said that the PAA approach should be considered a simplified version of the BBA and should be permitted when the PAA yields results that are a reasonable approximation of the results under the BBA. One respondent who disagreed stated that using one unified approach for all insurance contracts would improve comparability and provide decision-useful information in both presentation and disclosure. One professional organization representing international insurance entities noted that insurers with operations in the European Union support (a) the application of the BBA to all contracts and (b) including an explicit risk adjustment as well as a margin that represents expected profit.

Application of the PAA

36. The majority of respondents disagreed with the mandatory application of the PAA and noted that applying that approach should be optional. Those respondents noted that optionality would limit the operational burden of having to account for similar

contracts using two different models if certain contracts do not meet the criteria to be accounted for using the PAA. Some respondents agreed that the PAA should be mandatory if a contract has certain characteristics because it would promote comparability for similar contracts across issuing entities.

37. Most respondents noted that the criterion in which the coverage period of the contract is stated as one year or less is overly prescriptive and would not properly include all insurance contracts that should be accounted for using the PAA. Some respondents were concerned that this criterion would result in reporting entities accounting for the same type of contract using the PAA one year and the BBA the following year. Those respondents noted that this criterion is not practical because economic conditions can affect the duration of contracts that a reporting entity writes, and a reporting entity may write similar contracts for different durations to build or maintain relationships with a policyholder. Those respondents also noted that there would be challenges in applying the guidance in the proposed Update because certain "risk-attaching" reinsurance contracts technically cover two years of risks for underlying insurance policies and composite insurers manage one-year term contracts together with other longer term contracts with similar risks.

38. Nearly all respondents disagreed with applying the PAA if it is unlikely that during the period before a claim is incurred there will be significant variability in the expected value of net cash flows required to fulfill the contract, mainly because of the difficulty in interpreting the meaning of the criterion mentioned in the previous paragraph. Some respondents noted that this criterion could be read to include all or none of the short-duration contracts meant to be included in the PAA. Respondents noted that most property and casualty contracts could be eligible for the PAA model given that they generally have very predictable cash flows before a claim is incurred. However, it also can be argued that for those same contracts to bear "significant insurance risk" there would always need to be "significant variability in expected value of net cash flows." Those respondents were concerned that diversity in practice can result because of different interpretations of that criterion in the proposed Update.

39. The majority of respondents prefer existing U.S. GAAP for short-duration contracts instead of the proposed PAA, and some respondents also recommended amending the characteristics of a contract that should be accounted for using the PAA to reflect the existing U.S. GAAP definition of short-duration contracts.[2] Some respondents also noted that the characteristics of a contract that should be accounted for using the PAA in the proposed Update fails to capture certain insurance contracts that should be accounted for using that approach, such as mortgage insurance, and recommended that the characteristics should be more precise. Respondents also noted that the resulting differences in accounting for certain contracts using the guidance in the proposed Update and statutory accounting requirements should be considered, because that will significantly increase the costs and complexity for preparers. Due to the issues regarding the application of the PAA, many respondents recommended targeted improvements to current U.S. GAAP instead of the guidance in the proposed Update.

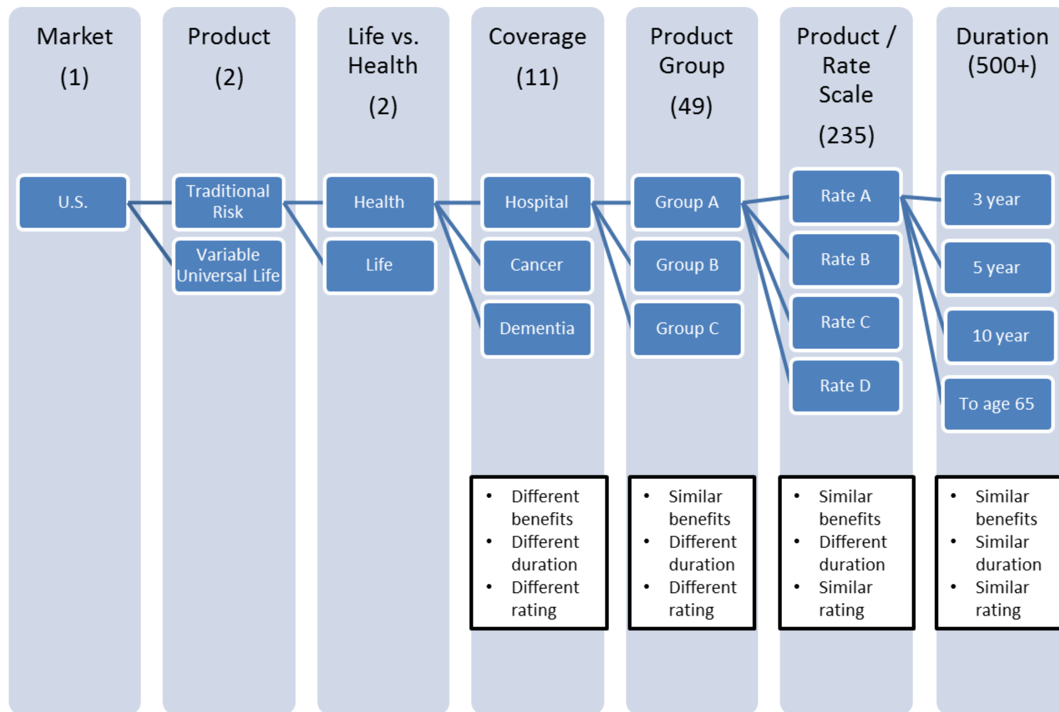
40. The simplifying assumptions used by field testing participants further highlighted the challenges with interpreting the PAA criteria. Several field testing participants who issue short-duration contracts noted that they were unable to determine whether certain contracts (typically those contracts with coverage periods extending beyond one year) would qualify for the PAA, and, therefore, assumed that the intent of the guidance in the proposed Update is not to apply the BBA to shorter duration contracts.

[2] Subtopic 944-20, Financial Services—Insurance—Insurance Activities, states that insurance contracts shall be classified as short-duration contracts or long-duration contracts depending on whether the contracts are expected to remain in force for an extended period. The factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are as follows for a short-duration contract: (a) The contract provides insurance protection for a fixed period of short duration and (b) The contract enables the insurer to cancel the contract or to adjust the provisions of the contract at the end of any contract period, such as adjusting the amount of premiums charged or coverage provided.

Definition of a Portfolio

41. While many respondents agreed with the principles of not combining different types of contracts and contracts that would result in a different revenue recognition pattern, many respondents disagreed with the definition of a portfolio in the proposed Update. They also noted that the current definition is either confusing or difficult to apply to revenue recognition, the onerous contract test, and deferred acquisition costs requirements in the proposed Update, and would result in significant implementation costs.

42. Respondents noted that the definition of a portfolio in the proposed Update would result in an overwhelming number of portfolios. Field testing and roundtable discussions highlighted that many life insurance entities were mainly concerned with the requirement that a portfolio contains contracts with similar duration, because reporting entities will be required to group policies by age of the policyholder or beneficiary, which can result in thousands of portfolios. Property and casualty insurance entities and some health insurance entities, however, were concerned with the requirement that a portfolio contain contracts that are subject to similar risks and priced similarly, because many property and casualty contracts insure multiple perils (for example, auto physical damage and liability) and the costs to separate those risks would outweigh the benefits. One field testing participant illustrated the significant number of portfolios that may result from applying the guidance in the proposed Update as follows:



43. Field testing results also illustrated the diversity in practice that may occur when applying guidance in the proposed Update related to the definition of a portfolio. While some field testing participants used simplifying assumptions for purposes of completing the field testing, in general, many of the field testing participants grouped contracts into portfolios in a different manner as follows:

a. By geography and product type

b. By product and originating year

c. By each individual contract

d. By contract issuance date (for example, contracts issued in all prior periods were grouped into one portfolio and contracts issued in each subsequent period were a separate portfolio)

e. By each line of business by underwriting month.

44. Generally, most respondents noted that having a detailed, prescriptive definition of a portfolio would result in more portfolios being deemed onerous, which would adversely impact the revenue recognition pattern and accounting for deferred acquisition costs. Other respondents noted that the proposed Update lacked

implementation guidance that would illustrate the intent of the definition of a portfolio, which would lead to different interpretations of the definition and cause issues with financial statement comparability.

45. Some respondents supported principles-based guidance for the definition of a portfolio that would provide for a consistent method of application for all insurers and would reflect how reporting entities group contracts, recognize revenue, and perform the onerous contracts test. Certain respondents recommended that the definition of a portfolio in the proposed Update should be consistent with the existing guidance in Topic 944 about grouping insurance contracts in a manner that reflects how a reporting entity acquires, services, and measures the profitability of its insurance contracts. Other respondents recommended that a portfolio of insurance contracts should be defined as a group of contracts that provide coverage for similar risks (a) that are priced similarly relative to the risk taken on, (b) that are managed together as a single pool, and (c) in which the margin or liability for remaining coverage is calculated for contracts within the portfolio by similar date of inception.

Contract Boundary

46. A majority of the respondents agreed with the requirements in the proposed Update for determining the contract boundary. Respondents who agreed viewed the contract boundary to be the end of the coverage period as stated in the policy or reinsurance contract. However, some respondents had specific concerns about applying the guidance in the proposed Update due to the following:

    a. Statutory and regulatory requirements

    b. Extended claim reporting periods

    c. Salvage and subrogation

    d. Yearly renewable term policies.

47. *Statutory and regulatory requirements* may prevent insurers from cancelling an insurance policy and/or increasing premiums charged to policyholders for certain

types of contracts. Respondents noted that statutory and regulatory standards should not extend the contract boundaries for contracts that typically have a coverage period of one year and recommend that the guidance in the proposed Update address how insurers should consider statutory and regulatory requirements in determining the contract boundary.

48. *Extended claim reporting periods* will occasionally be offered for certain products that typically have coverage periods for one year. Respondents noted that the guidance in the proposed Update did not clearly indicate if the contract boundary should be extended to include the claim reporting period, and those respondents generally do not agree that the contract period should be extended in those situations because the risk protection provided would not change.

49. *Salvage and subrogation* is occasionally collected over an extended period, and respondents were uncertain if the guidance in the proposed Update intended for preparers to extend the revenue recognition period to the period when salvage and subrogation is fully collected.

50. *Yearly renewable term* reinsurance contracts are long-duration contracts that cover policies written during the coverage period but can be cancelled or repriced each year. Ceding companies will account for those arrangements using the same model applied to the underlying contracts included in the arrangement, which most likely would be the BBA. However, the assuming company could view that arrangement as having a one-year contract boundary due to the ability to reprice the contract each year while the underlying contracts could be long term and the expected cash flows would include multiple years of cash inflows and estimated cash outflows.

51. Field testing participants generally agreed with the definition of a contract boundary. However, participants expressed similar concerns as respondents in situations where a statutory or regulatory requirement (a) prohibited the insurer's ability to fully price insurance contracts for the risks of that portfolio or (b) cancelled the policyholder's contract. Certain field testing participants noted that a similar product offered in two different countries or states could be required to follow two separate accounting models due to regulatory restrictions, even though

management believes the contracts issued have the same economics and are priced similarly.

52. Some respondents recommended that the guidance in the proposed Update clarify whether or not renewal rights should be considered when determining the contract boundary. Those respondents noted that, generally, renewal rights are only a commitment by the insurer to renew and the policyholder is free to accept or reject a policy renewal, and that the costs to estimate fulfillment cash flows for renewal rights that have been offered but not yet accepted by the policyholder would be substantial.

Fulfillment Cash Flows

Types of Cash Flows Included

53. While many respondents generally agreed with the types of cash flows that would be included in the measurement of fulfillment cash flows, many respondents also generally disagreed. Those respondents who generally agreed and generally disagreed noted that deferred acquisition costs should be included in the measurement of fulfillment cash flows and should not reduce the margin under the BBA and the liability for remaining coverage under the PAA since it would more closely match the insurance contract cash flows with the related expenses. Some respondents stated that deferred acquisition costs should be presented separately in the balance sheet, because the amounts deferred would be more transparent to financial statement users. Some respondents also noted that in addition to deferred acquisition costs, other types of cash flows such as premium taxes paid to third parties, policyholder dividends, fixed and variable direct overhead expenses, and policy maintenance expenses should be included in the measurement of fulfillment cash flows to better match insurance contract cash flows with the related expenses. Some respondents who agreed with the types of cash flows that would be included in the measurement of fulfillment cash flows noted that those cash flows should exclude the costs of doing business, such as allocated overhead costs, and include only cash flows between the insurer and the policyholder or beneficiary.

54. Some respondents recommended that the guidance in the proposed Update should clarify whether claims handling are included in the measurement of fulfillment cash flows or are calculated and presented separately. One respondent stated that claims handling costs are incurred as part of the insurance policy and therefore should be included in the measurement of fulfillment cash flows. Other respondents noted that including claims handling costs in the measurement of fulfillment cash flows would add complexity with no perceived benefits and should be calculated and presented separately.

Updating Assumptions Each Reporting Period

55. Approximately half of the respondents who commented on the frequency with which assumptions are updated agreed that the assumptions used in the measurement of the fulfillment cash flows should be updated each reporting period, and approximately half disagreed.

56. For long-duration contracts accounted for using the BBA, several respondents noted that assumptions such as lapse rates, mortality, morbidity, and benefit elections should only be updated when current assumptions are no longer representative of persistent conditions. Those respondents acknowledged the importance reviewing assumptions periodically and preferred a principle that allows reporting entities to review assumptions each reporting period but recognize changes in estimates of cash flows due to changes in assumptions only when there is an indication that the change in nonmarket assumptions is persistent, similar to the existing U.S. GAAP requirements for goodwill impairment testing. Other respondents noted that a requirement to update assumptions annually would be easier to implement than a principle or the guidance in the proposed Update.

57. Some respondents highlighted that the reserving process for short-duration contracts differs significantly from the reserving process for long-duration contracts. Those respondents noted that it would be nearly impossible to update the large number of assumptions used in reserve studies for certain types of short-duration contracts quarterly and stated that this requirement would add unnecessary

costs and complexity to the reserving process. Some of those respondents also recommended the principles-based approach or the requirement to update assumptions (or reserve studies) annually as described in paragraph 56 above.

Explicit, Unbiased, Probability-Weighted Estimate of Future Cash Flows

58. Most respondents disagreed that the fulfillment cash flows for contracts measured using the BBA and the liability for incurred claims for contracts measured using the PAA should be based on an explicit, unbiased, and probability-weighted estimate (that is, the mean) of the future cash flows. A significant number of respondents disagreed with applying that guidance to property and casualty insurance contracts. Some respondents generally agreed with applying that guidance to life insurance contracts.

59. Many respondents noted that the guidance in the proposed Update would replace existing actuarial reserving methods for property and casualty claim liabilities with stochastic modeling, which would not result in improved estimation. Those respondents noted that the proposed stochastic modeling would give financial statement users a false sense of accuracy, would not be the preferred reserving method among actuaries, and would largely be untested as an appropriate approach to estimating reserves.

60. Respondents who disagreed also noted that reporting entities would not be able to apply the guidance in the proposed Update to liability estimates for certain claims such as mass tort claims and asbestos exposures because there is no widely accepted methodology for estimating those reserves. Field testing and certain roundtable participants noted that reserves for those types of claim liabilities are often estimated using a methodology similar to that of how litigation reserves are estimated.

61. Some respondents who disagreed also noted that using an explicit, unbiased, and probability-weighted estimate (that is, the mean) is inconsistent with statutory requirements for estimating reserve balances and stated that this guidance would likely lead to inadequate loss reserves, which is the most common cause of

insurance company insolvencies. Respondents also were concerned that for short-duration contracts, the proposed approach would be extremely costly to implement and execute periodically, would reduce the transparency of the estimation process, and would not be applied consistently across the industry. A significant number of respondents recommended that the guidance in the proposed Update should require using an actuarial central estimate, described in Actuarial Standard of Practice No.43, *Property/Casualty Unpaid Claim Estimates*, as an actuarially determined expected value over a range of reasonably possible outcomes. One respondent noted that including a reference to or language from ASOP 43 would eliminate management bias by requiring management to establish reserves equal to the actuarially determined estimate, while other respondents noted that this would increase the number of processes and the costs to comply with the requirements of Sarbanes-Oxley Section 404, *Management Assessment of Internal Controls*.

62. The respondents who generally agreed with using explicit, unbiased, and probability-weighted estimates (that is, the mean) of the future cash flows noted that this guidance is mainly consistent with existing reserving practices for long-duration contracts. Some respondents disagreed with requiring "unbiased" estimates, because any estimate requires judgment and that may create issues with auditability.

Recognizing Changes in Cash Flow Estimates in Net Income

63. While many respondents disagreed with the approach in the proposed Update to recognize changes in estimates of cash flows (other than the effect of changes in the liability arising from changes in the discount rates) in net income in the reporting period, some respondents generally agreed. Those respondents who generally agreed noted that recognizing changes in estimates of cash flows in net income would be consistent with the current practice for accounting for short-duration contracts.

64. Substantially all respondents who disagreed instead supported unlocking the margin for changes in estimates of cash flows (other than the effect of changes in the liability arising from changes in the discount rates) for the following reasons:

    a. Changes in estimates of cash flows in net income in the current reporting period inaccurately imply that such cash flow impacts have been currently realized.

    b. Recognizing changes in estimates of cash flows in current-period net income would create unnecessary accounting volatility that would not necessarily be representative of the economics of the insurance contracts because the volatility would be the result of subjective projections of future economic conditions that may not be persistent.

    c. Recognizing changes in estimates of cash flows in net income would produce financial results that would be difficult to understand and interpret.

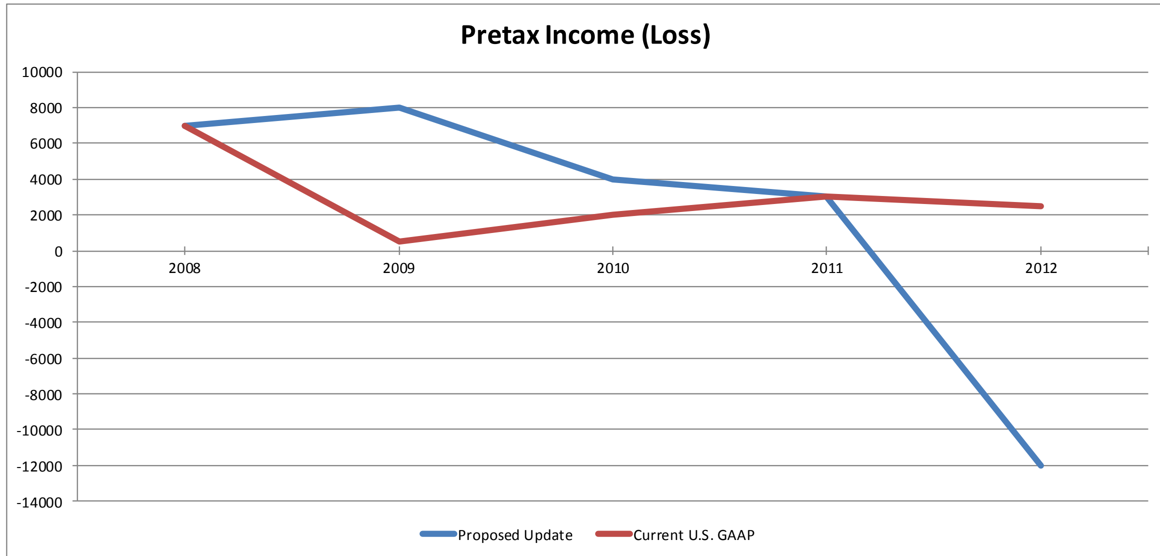
    d. Locking the margin contradicts the concept in the proposed Update of disallowing day one gains, since a day two favorable change in estimate would be reflected immediately in net income.

65. Some field testing participants and roundtable participants also noted that unlocking the margin for changes in estimates of cash flows would eliminate the need to periodically assess whether the remaining expected cash outflows exceed the remaining expected cash inflows and to recognize the remaining margin as revenue in net income.

66. One respondent, certain field testing participants, and some roundtable participants noted that if the margin was unlocked for changes in estimates of cash flows (other than the effect of changes in the liability arising from changes in the discount rates), the requirement in the proposed Update to disclose a rollforward of the margin would provide users with decision-useful information and adequate transparency about the changes in estimates of cash flows.

67. Roundtable participants discussed field testing results shared by certain life insurance field testing participants, which showed that updating assumptions

periodically, particularly on long-duration contracts, can have significant short-term effects on pretax income. For example, the following graph depicts the impact on pretax income of a positive change in assumptions in 2009 and a negative change in assumptions in 2012 for certain traditional life insurance contracts included in field testing:



Discount Rates and Discounting

Discounting the Liability for Incurred Claims

68. For contracts measured using the PAA, most respondents (mainly property and casualty and health insurers), including some users, disagreed that a reporting entity should discount the liability for incurred claims. While most of those respondents agreed with the concept of the time value of money, they noted that discounting the liability for incurred claims would be costly and would not provide decision-useful information due to the following:

    a. There is uncertainty in both the amount and the timing of claim payments, which causes significant subjectivity and variability in the calculated discount.

    b. It is not consistent with the property and casualty business model where claims are typically managed internally, analyzed externally, and ultimately settled all on a nominal (that is, undiscounted) basis.

c. The financial condition of a reporting entity would be overstated if reserves are recorded at a discounted amount, and that may increase the perceived financial risk of insurance entities.

d. Policy administration and reserving systems would need to be modified.

69. A small number of respondents generally agreed that the liability for incurred claims should be discounted because the time value of money is a fundamental economic concept that should be considered in financial reporting. However, a few of those respondents supported discounting the liability for incurred claims only if the risk and uncertainty associated with those cash flows also is reflected in the financial statements, either through a risk adjustment or through an implicit margin. Some respondents supported discounting the liability for incurred claims only if the claims pattern and the ultimate cost associated with those reserves are fixed and determinable, which is consistent with current practice.

70. Field testing results also highlighted the variability in the calculated discount on the liability for incurred claims. A few field testing participants illustrated that when there are changes to the incurred-but-not-reported reserves, or when a reporting entity reallocates reserves among accident years, the calculation as well as tracking the historical data becomes complex and the discount amounts can significantly change.

71. Most respondents agreed that a reporting entity should be allowed to elect not to discount portfolios when the effects of discounting are immaterial or when the incurred claims are expected to be paid within one year of the insured event, because the cost would outweigh the benefit of applying a discount rate to claims that are settled quickly. However, many of those respondents noted that the practical expedient in the proposed Update would not be operable and would not apply to a significant number of reporting entities due to the following:

a. The practical expedient requires reporting entities to evaluate claim payments for portfolios of insurance contracts. If there are multiple perils included within a portfolio that have different expected claim payment patterns, or if not all of

the claims are expected to be paid within one year, then the practical expedient would not apply.

b. It is difficult to know with sufficient certainty that discounting will not be material to a portfolio or that the incurred claims within a portfolio are expected to be paid within one year, due to ongoing changes in the settlement environment (for example, litigation and different settlement practices used for various types of exposures). A small number of respondents noted that historically, all portfolios have had some claims that have taken over a year to settle.

72. One roundtable participant noted that many health insurers' medical and dental portfolios would qualify for the practical expedient because the claims are paid very quickly. For the remaining portfolios that do not qualify for the practical expedient, discounting would be appropriate and consistent with the current accounting for those types of claims.

73. Many respondents recommended that the practical expedient for not discounting the liability for incurred claims should be revised so that it would apply to more reporting entities. Those recommendations included the following:

a. The practical expedient should apply to individual claims that are paid within one year and not to the portfolio of contracts.

b. The time period that a reporting entity expects to pay the incurred claims should be extended beyond one year (for example, two years or five years).

c. Reporting entities should be allowed to elect not to discount the liability for incurred claims if a majority or a significant portion of claims are expected to be paid within one year of the insured event.

d. The practical expedient should be extended to all short-duration contracts.

Discount Rate Methodology

74. While many respondents generally agreed that the discount rates used by a reporting entity for nonparticipating contracts should reflect the characteristics of

the insurance contract liability and not those of the assets backing that liability, many respondents disagreed. Some respondents who agreed noted that reflecting the characteristics of the insurance contract liability would provide a more consistent measurement among entities, and there are certain key differences between the liabilities and the assets that support them that should be reflected in the financial statements. If the discount rates were to reflect the assets backing the liability, then differences in the investment strategy among reporting entities would create differences in the measurement of similar insurance contracts.

75. Most of the respondents who disagreed with using discount rates that reflect the characteristics of the insurance contract liability supported using discount rates that are derived from the expected return on the actual asset portfolio backing the liabilities (or a reference portfolio of assets with similar duration as the liabilities). Some of those respondents stated that an asset-based approach would better reflect the pricing practices and expected profitability of a portfolio of contracts. Other respondents noted that if the discount rates reflected the characteristics of the insurance contract liability, then short-term fluctuations in asset spreads would have an asymmetrical impact on the measurement of insurance liabilities and the assets supporting those liabilities. One respondent commented that excluding the credit risk premium from the liability discount rates would create an accounting mismatch between the insurance contract liabilities and the assets backing the liabilities, which would result in volatility in OCI and in equity due to short-term fluctuations in market credit risk premiums that are not representative of the economics of the business.

76. Most respondents agreed that the method for calculating the discount rates should not be prescribed and supported the inclusion of both the "top down" and "bottom up" approaches to determining the discount rates. The respondents who disagreed were concerned that allowing flexibility for reporting entities to calculate the discount rates will compromise the comparability of reporting entities' financial statements, while many respondents who agreed noted that the required disclosures about discount rates and assumptions used would provide sufficient information and would promote financial statement comparability. A few respondents also

commented that many property and casualty insurance entities do not have sufficient expertise to calculate the appropriate yield curves without more prescriptive guidance. Many respondents who commented on the discount rate methodology recommended that additional clarification or implementation guidance should be added to the proposed Update about the following:

a. How to determine the liquidity adjustment when using the "bottom up" approach, including whether the liquidity adjustment is determined on the basis of the perspective of the insurer or the perspective of the policyholder

b. The asset classes or types of assets that a reporting entity should include in or exclude from the reference portfolio when it applies the "top down" approach

c. The ability to use forecasts of unobservable inputs that tend to put more weight on longer term trends than on short-term fluctuations to mitigate balance sheet volatility created by the effects of changes in credit spreads when determining the yield curve under the "top down" approach

d. Allowing reporting entities to use Level 3 inputs for points on the yield curve where there is no observable market data, especially for liabilities that are expected to be settled many years from the reporting date.

77. Some respondents suggested that the guidance in the proposed Update should include a practical expedient for reporting entities to use a risk-free rate, a high-grade corporate bond rate, or a treasury yield curve when discounting the insurance contract assets and liabilities. Those respondents noted that a practical expedient would reduce the costs and complexity of implementing the guidance in the proposed Update and would promote the comparability of reporting entities' financial statements.

78. Field testing results highlighted that calculating the liquidity adjustment when using the "bottom up" approach to determining discount rates was difficult without prescriptive guidance. Only one field testing participant that used the "bottom up" approach determined a liquidity adjustment, and calculated the amount as the difference between the average daily yields of 5-year U.S. Treasury bonds and 10-

year U.S. Treasury bonds. All other field testing participants using the “bottom up” approach used either a rate prescribed in regulatory requirements or a risk-free rate without adjustment. Those field testing participants and some respondents noted that the complexities in determining that adjustment each period may outweigh the benefits of discounting at a rate that may more closely reflect the characteristics of the insurance contract liabilities.

79. Some field testing participants also recommended that for the “top down” approach to determining discount rates, additional clarification should be added to the guidance in the proposed Update about using unobservable inputs for points on the yield curve where there is either no deep and liquid market or no observable market data. Certain field testing participants interpreted the guidance in the proposed Update to require a market consistent discount rate and held constant the last point on the observable market yield curve for periods beyond the last observable point. Those field testing participants also tested the sensitivity of the liability and total comprehensive income to a change in discount rate assumptions used to discount cash flows beyond the point where observable rates are the best indicator of market assumptions by discounting fulfillment cash flows for a product line assuming a 50-basis point increase in rates for points on the yield curve after 30 years and after 20 years. The impact on fulfillment cash flows is as follows:

Point Impacted	**Impact on Present Value of Fulfillment Cash Flows**
30 + years	(5.1%)
20 + years	(8.3%)

80. This field testing illustrated that interpreting the guidance in the proposed Update to require market consistent discount rates can result in small changes in discount rates in periods far into the future having material impacts on the present value of fulfillment cash flows for liabilities with significantly long durations. Some field testing participants recommended that the guidance in the proposed Update should allow grading to a long-term average to prevent that volatility and to address the

lack of correlation between current market rates and what will occur 20 to 30 years into the future.

Recognizing the Effects of Changes in Discount Rates in OCI

81. Most respondents who supported discounting agreed with the intent to mitigate volatility in the income statement by requiring that the effects of changes in the discount rates be recognized in OCI. Many respondents also agreed that changes in underwriting performance should be segregated from changes in investment performance. However, many respondents were concerned that requiring reporting entities to recognize the effects of changes in discount rates in OCI would create accounting mismatches for those assets that are currently accounted for at fair value through net income or that will be required to be accounted for at fair value through net income as a result of the guidance in the proposed FASB Accounting Standards Update, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*.

82. Field testing results highlighted that accounting mismatches would be created in many instances by requiring reporting entities to recognize the effects of changes in the discount rates through OCI. Two field testing participants classify all of their investments as trading investments, which are accounted for at fair value through net income. For most other field testing participants, a significant portion of the investment portfolios were accounted for at fair value through OCI while some investments (for example, derivatives) were accounted for at fair value through net income.

83. Some respondents recommended that the guidance in the proposed Update should be aligned with the guidance in the proposed Update on financial instruments to eliminate accounting mismatches. Many respondents also recommended that reporting entities should be allowed an option to recognize the effects of discount rate changes either through OCI or through net income. Some of those respondents noted that the election should be made at the portfolio level, while other

respondents recommended that the election should be an accounting policy election for all portfolios.

Other Discount Rate Comments

84. While some respondents agreed that interest expense generally should be based on the discount rates determined at the date the portfolio of contracts was initially recognized, some respondents disagreed. Those respondents who agreed and who disagreed generally do not support discounting the liability for incurred claims for contracts measured using the PAA. However, if discounting was required, many respondents agreed that the discount rate should be based on a locked-in accretion rate, and some respondents and field testing participants recommended that interest expense should be based on the discount rates determined either at the date a claim is incurred or on an accident-year basis. That would eliminate some of the costs and operational complexity associated with capturing the data necessary to calculate the changes between the current discount rates and the initial locked-in discount rates. A few respondents also recommended that the proposed Update should include implementation guidance to illustrate how the guidance about using a locked-in interest rate would apply to portfolios of insurance contracts.

85. Many respondents agreed that upon any change in expectations of the crediting rates used to measure the insurance contract liability for insurance contracts with discretionary participation features, the interest accretion rates should be reset. However, a significant number of those respondents disagreed that the rate should be reset in a manner that recognizes any changes in an estimated crediting rate on a level-yield basis over the remaining life of the contract. Those respondents noted that recognizing the change on a level-yield basis over the remaining life of the contract would create accounting mismatches unless the changes in the crediting rate also were level and over the term of the contract. Some respondents suggested that the initial yield-curve should be updated to reflect the timing of the expected crediting and the timing of cash flows.

Margin for Contracts Measured Using the Building Block Approach

Prohibiting Gain Recognition at Initial Recognition

86. Most respondents agreed that that a reporting entity should not recognize a gain at initial recognition of an insurance contract (when the expected present value of the cash outflows is less than the expected present value of the cash inflows) but, rather, should defer that amount as profit to be recognized in the future. Those respondents noted that this guidance in the proposed Update is generally consistent with other guidance in existing U.S. GAAP.

87. Nearly all respondents who agreed also recommended that the margin for contracts measured using the BBA should be unlocked for changes in fulfillment cash flows due to changes in assumptions to prevent a reporting entity from recording day two gains in the statement of comprehensive income for contracts that remain in force for a significant number of years. Respondents noted that in order for the margin to truly reflect the unearned profit for a contract at each reporting date, unlocking the margin is necessary; otherwise, the margin would only reflect the unearned profit at contract issuance, not at each reporting date.

88. Several respondents disagreed that a reporting entity should recognize a margin at contract issuance. Some of those respondents noted that the margin may imply a false level of precision in the future profits attributable to the contracts issued. One respondent supported recognizing a gain through net income at contract issuance because deferring profits as prescribed in the proposed Update would be a "plug" that is locked in for the duration of the contract. That respondent noted that recognizing gains and losses at contract issuance, as well as differences between expected and actual results each reporting period, would better communicate the quality of a reporting entity's underwriting practices.

Recognizing a Loss at Contract Inception

89. Nearly all respondents agreed that a loss at initial recognition of a portfolio of insurance contracts should be recognized immediately in net income (when the

expected present value of the cash outflows exceeds the expected present value of cash inflows). Those respondents noted that this guidance in the proposed Update is consistent with the general loss recognition criteria required by other guidance in existing U.S. GAAP.

90. Some respondents who agreed recommended that the guidance in the proposed Update should clarify whether recognizing losses at inception would be applied to both open portfolios (where cohorts of contracts would be continually added to a portfolio) and closed portfolios (where the portfolio would be initially established and contracts would not be subsequently added) and how recognizing losses at inception would be applied to open portfolios. One respondent who generally agreed with recognizing losses at inception of a portfolio of insurance contracts noted that if the loss at the inception date is created solely from excluding a reporting entity's own credit risk from the discount rate, then that loss should not be recognized immediately and should instead be deferred and amortized using an effective yield method similar to those used for other discounted borrowings.

91. The few respondents who disagreed that that a loss at initial recognition of a portfolio of insurance contracts should be recognized immediately in net income date stated that recognizing losses at inception date does not interact well with the concept of a locked-in margin. One respondent noted that if a reporting entity recognized a loss at inception of a portfolio of contracts but subsequent changes in fulfillment cash flows resulted in a profitable portfolio, the guidance in the proposed Update would prevent that reporting entity from recognizing the true profitability of the portfolio over the duration of the portfolio of insurance contracts.

One-Margin Approach or the International Accounting Standards Board (IASB) Approach

92. Many respondents supported using a one-margin approach described in the guidance in the proposed Update, and some of those respondents generally supported the one-margin approach if the margin was unlocked at subsequent reporting dates. Those respondents noted that the one-margin approach would be

more cost effective and less complex than recognizing both an explicit risk adjustment and a contractual service margin as proposed in the 2013 IASB Exposure Draft, *Insurance Contracts*, and that the one-margin approach is more a more practical and easily understood mechanism for eliminating gains on contract issuance. One insurance regulator supported the one-margin approach because it removes the uncertainty and judgment necessary to determine an explicit risk adjustment, and another respondent was concerned that the explicit risk adjustment would become a way for management to introduce bias into the measurement of the insurance contract liabilities. Some respondents who supported the one-margin approach also stated that the IASB approach would imply a false level of precision in the measurement of insurance contract liabilities, and the lack of a prescribed approach to measuring the risk margin will lead to diversity in practice. One respondent noted that the benefits of recognizing a risk adjustment for long-duration contracts does not justify the costs and complexities since the risk adjustment will be relatively small compared to the insurance contract liability.

93. Many respondents who supported recognizing an explicit risk adjustment and a contractual service margin have operations that would be impacted by the IASB Exposure Draft. Some respondents supported recognizing an explicit risk adjustment for contracts accounted for using the PAA because it would reflect uncertainties in both the timing and amount of cash flows. One respondent noted that the explicit risk adjustment (a) is necessary to quantitatively express the measurement of uncertainty inherent in the insurance contracts liability and (b) would increase financial statement transparency. Another respondent stated that the explicit risk adjustment would reflect the economics and business of insurers (which is selling and managing risks) and provide more meaningful information to financial statement users.

Unlocking the Contractual Service Margin and Measuring the Risk Adjustment

94. Respondents who supported the IASB approach generally agreed that the contractual service margin should be unlocked and that the approach to calculating

the risk adjustment should not be prescribed. Many respondents who agree with the one-margin approach also noted that unlocking the margin would greatly simplify the model by eliminating the need to retain information about historical assumption changes and adequately reflect inherent risks in the liability, which would remove the need for a risk adjustment.

95. Many respondents who supported the IASB approach noted that both the contractual service margin and the risk adjustment should be unlocked. One respondent recommended that the IASB should remove its proposed confidence level disclosure because it would be exceedingly complex to calculate and very subjective and would not provide decision-useful information.

96. Most respondents who agreed that the approach to calculating the risk adjustment should not be prescribed noted that it would be difficult to establish an all-encompassing approach appropriate for all risks and products throughout different jurisdictions. One respondent who agreed was concerned that the IASB Exposure Draft lacks the specificity needed to ensure a sufficient level of comparability among insurers. Another respondent representing the perspective of short-duration contract issuers noted that an explicit risk adjustment cannot be reliably determined due to a lack of data points and difficulties with obtaining the necessary reliable data.

Recognizing the Margin

97. While many respondents agreed that a reporting entity should recognize the margin as the reporting entity is released from risk under the insurance contracts as evidenced by a reduction in the variability of cash outflows, many respondents disagreed. Those respondents who agreed noted that recognizing the margin as the reporting entity is released from risk would result in more decision-useful information and the guidance in the proposed Update would allow preparers to tailor the pattern of release from risk to the specific portfolio of contracts. However, several respondents were concerned that reporting entities may inconsistently apply that approach to many different long-duration products with

different patterns of release from risk, and some respondents recommended that the guidance in the proposed Update should either prescribe a method for determining the release from risk or clarify the principle of release from risk.

98. One respondent and certain field testing participants noted that recognizing the margin as a reporting entity is released from risk would not always reflect the economics of certain long-duration contracts because certain insurance contracts would have small amounts of margin recognized in revenue in the early years of the contract that would not be sufficient to cover the current overhead and operating costs, and that would inappropriately indicate that the contracts are unprofitable. Several respondents recommended that the guidance in the proposed Update should permit reporting entities to recognize the margin in revenue on the basis of the passage of time unless the pattern of claims and benefits would make another pattern more appropriate.

Accreting Interest on the Margin

99. While many respondents generally agreed that interest should be accreted on the margin, some respondents disagreed. Those respondents who agreed noted that presenting interest accretion in insurance contract revenue would result in premium revenue recognition that is in excess of actual premiums received and would unnecessarily gross up the statement of comprehensive income. They recommended that the impact of interest accretion should be presented separately from insurance contract revenue.

100. Some respondents who disagreed that interest should be accreted on the margin noted that this would increase the complexity of the BBA without providing additional decision-useful information. Other respondents stated that a reporting entity should only accrete interest on the fulfillment cash flows and not the margin, because the margin inherently includes the impact of discounting (that is, the margin includes the excess of the present value of the expected cash inflows over the present value of the expected cash outflows).

101. Some respondents stated that that accreting interest on premiums received upfront would grossly overstate insurance contract revenue and accumulated other comprehensive income. Field testing results illustrated that accreting interest on premiums received upfront may increase premium revenue by 30–50 percent for certain types of long-duration contracts.

102. Certain field testing participants who agreed that interest should be accreted on the margin noted that in situations in which the margin represents a large portion of the insurance contract liability, accounting mismatches become prominent. That is because the accretion rate applied to the margin does not reflect current market rates and the current market rates would be applied to the underlying assets.

Onerous Contracts

103. Most respondents disagreed that if the expected cash outflows (including qualifying acquisition costs) of a portfolio of insurance contracts would exceed the expected cash inflows, a reporting entity should recognize the remaining margin immediately in net income for contracts accounted for using the BBA or recognize an additional onerous contract liability and a corresponding expense for contracts accounted for using the PAA.

104. Most respondents representing the perspective of long-duration contract issuers supported unlocking the margin instead of an onerous contract test because under that approach, adverse development on a portfolio of contracts would gradually reduce the margin until it is zero, and all subsequent adverse development would be recognized in net income. Those respondents stated that periodic onerous contract tests would be costly and complex because of the requirement to continuously capture, update, and retain information about historical cash flows for the duration of every cohort within each portfolio for which a separate margin and earned interest rate is maintained.

105. Most respondents representing the perspective of short-duration contract issuers disagreed that a reporting entity should record additional reserves prior to the occurrence of an adverse low-frequency, high-severity event as a result of the

onerous contract test. Those respondents stated that the guidance in the proposed Update implies a false level of precision in estimating the impact of low-frequency, high-severity events and would distort the financial results of two reporting periods (recording estimate in one period and reversing it the following period) if the adverse event does not occur. Those respondents also noted that this would not provide any decision-useful information and that preparers would not consistently apply that guidance. Many respondents recommended that the guidance in the proposed Update should be consistent with existing U.S. GAAP for evaluating premium deficiencies and subsequent events.[3]

106. Some respondents recommended that the guidance in the proposed Update should clarify how a reporting entity should perform the onerous contract test, including the following:

   a. Whether the onerous contract test should include the impact of reinsurance

   b. Whether the historical or current discount rate should be used in discounting cash flows

   c. If the onerous contract test should be performed using cumulative cash flows or prospective cash flows

   d. If the onerous contract should be performed at the contract level or the portfolio level.

Acquisition Costs

Successful Efforts

107. While many respondents disagreed that the direct acquisition costs presented with the margin should include only the costs directly related to a reporting entity's

[3] Subtopic 944-60, Financial Services—Insurance—Premium Deficiency and Loss Recognition, states that a premium deficiency for short-duration contracts shall be recognized if the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs, and maintenance costs exceeds related unearned premiums. A premium deficiency shall first be recognized by charging any unamortized acquisition costs to expense to the extent required to eliminate the deficiency, and if the deficiency is greater than unamortized acquisition costs, a liability shall be accrued for the excess deficiency.

selling efforts that result in obtaining the contracts in the portfolio and that all other acquisition costs should be recognized as expenses when incurred, some respondents agreed. Numerous respondents who commented on the accounting for acquisition costs noted that the guidance in the proposed Update is mainly consistent with existing U.S. GAAP (with the exception of deferring direct response advertising costs). Some respondents recommended that the guidance in the proposed Update should be consistent with existing U.S. GAAP and allow reporting entities to defer direct response advertising costs, because that would properly match the expenses with the related revenues and because a change from existing U.S. GAAP would be burdensome.

108. Some respondents who agreed with the acquisition costs that would be deferred under the guidance in the proposed Update also supported including other costs if it resulted in convergence with IFRS, either because convergence is a priority or those respondents did not consider the difference to be material.

109. Many respondents who disagreed that the direct acquisition costs presented with the margin should include only the costs directly related to a reporting entity's selling efforts that result in obtaining the contracts in the portfolio supported including acquisition costs related to successful and unsuccessful selling efforts. Those respondents noted that including acquisition costs related to both successful and unsuccessful selling efforts would be less complex, would result in convergence with IFRS, and would be consistent with the costs that reporting entities consider in pricing their products. Some respondents stated that if profitability is based on the pooling of risk across the portfolio and is not based on the risk of any single contract, consideration of all costs of acquiring that portfolio should be included in the evaluation of profitability. Other respondents noted that unsuccessful efforts may lead to client relationships that eventually result in insurance contract sales, and if the margin represents expected profits, unsuccessful efforts should be included as part of the cash outflows.

110. A few respondents recommended that the guidance in the proposed Update clarify whether or not certain costs and commissions already incurred (for example,

underwriters' salaries previously incurred that relate to successful underwriting efforts) would be included in deferred acquisition costs. Other respondents recommended that deferred acquisition costs include premium taxes and other costs that are included in the insurance contract pricing, guaranty fund assessments, and certain overhead expenses.

Reducing the Margin and the Liability for Remaining Coverage

111. While many respondents disagreed that the measurement of the margin for contracts measured using the BBA and the liability for remaining coverage for contracts measured using the PAA should be reduced for direct acquisition costs incurred, some respondents agreed. The respondents who disagreed supported separately presenting acquisition costs as an asset on the balance sheet, which is consistent with existing U.S. GAAP. Some respondents acknowledged that since the amortization of acquisition costs would be presented as a separate line item in the statement of comprehensive income, it would be appropriate to present deferred acquisition costs separately on the balance sheet. Many respondents who disagreed stated that because acquisition costs are incurred when fulfilling an insurance contract, those costs should be treated like any other cash outflow. A few respondents noted that under existing U.S. GAAP, the guidance in the proposed Update or the guidance in the IASB Exposure Draft would be acceptable for presenting deferred acquisition costs.

Recognition

112. While most respondents agreed that a reporting entity should recognize acquisition costs as an expense in net income in the same pattern that it recognizes the margin for contracts measured using the BBA or in the same pattern that it reduces the liability for remaining coverage under the PAA, some respondents disagreed. The respondents who agreed acknowledged that recognizing acquisition costs in the same pattern as the margin is released provides a more meaningful depiction of the net profit earned for services provided during the period. Many of the respondents

who disagreed noted that acquisition costs are part of fulfilling an insurance contract and should be treated similarly as any other cash outflow when determining the margin.

113. Certain respondents recommended that the guidance in the proposed Update clarify whether qualifying acquisition costs should be updated each reporting period as an adjustment to the margin or recognized immediately in net income. One respondent noted that the practical expedient that allows a reporting entity using the PAA to recognize all costs of acquiring a portfolio of insurance contracts when incurred as an expense in net income if the contracts' coverage periods are one year or less should be expanded to all contracts that qualify for the PAA, not just those that qualify due to the duration of the contract. Another respondent recommended adding a practical expedient to allow reporting entities that have each policy as a separate portfolio to account for deferred acquisition costs at a more aggregated level than on an individual contract basis.

Insurance Contract Revenue

Recognition

114. Some respondents, field testing participants, and roundtable participants disagree that a reporting entity should recognize premiums from long-duration contracts when earned and support retaining existing U.S. GAAP that requires a reporting entity to recognize revenue from long-duration contracts when due. Those stakeholders said that the premiums due methodology more accurately reflects the economics of the business and is easier for users to understand than the guidance in the proposed Update, and would continue to provide users with relevant volume information in the statement of comprehensive income.

115. Several respondents also commented that the proposed approach to recognizing insurance contract revenue is difficult to apply to all types of insurance contracts. For example, recognizing insurance contract revenue over the coverage period for title insurance contracts would not be operable since the duration of the contract is

unknown (coverage ends when there is a change in ownership or when a mortgage is satisfied).

116. Many property and casualty insurance entity respondents stated that for contracts accounted for using the PAA, recognizing revenue on the basis of the expected timing of incurred claims and benefits would add unnecessary costs and complexity to the model and would result in diversity in practice. Some of those respondents noted that for short-duration contracts, different revenue recognition patterns would not provide decision-useful information to users because the entire premium amount will be earned within one year.

117. Some respondents and field testing participants noted that insurance contract revenue should be recognized over both the coverage period and the settlement period to properly reflect the risks that extend to the settlement period.

Presentation

118. Most respondents generally agree that users of financial statements would obtain relevant information that faithfully represents the entity's financial position and performance if, in net income, for all insurance contracts, an entity presents insurance contract revenue and incurred expenses rather than only information about changes in margins (that is, the net profit). However, many of those respondents support the existing U.S. GAAP presentation instead of the presentation prescribed in the proposed Update because they noted that the proposed guidance is overly complex, would no longer present volume information, and the connection between the premium line item and the size, scale, and growth of a portfolio of contracts would be lost. Many preparers and users stated that the presentation prescribed in the proposed Update would not provide decision-useful information and would not reflect the manner in which entities manage their business. For contracts accounted for using the PAA, some respondents were concerned that different reporting entities' interpretations of the expected timing of incurred claims will lead to a lack of financial statement comparability.

119. Nearly all respondents agreed that the presentation of the statement of comprehensive income prescribed in the proposed Update would be an improvement over the presentation proposed in the 2010 FASB Discussion Paper, *Preliminary Views on Insurance Contracts*, in which only net changes to the margin would be presented in the statement of comprehensive income. Some roundtable participants preferred a summarized margin approach and detailed disclosures due to the complexity in calculating insurance contract revenue amounts.

Estimated Returnable Amounts

120. Many respondents disagreed that, for all contracts, revenue should exclude any amounts received that an entity is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs and that expenses should exclude the corresponding repayment of those amounts. However, some respondents generally agreed. The respondents who disagreed noted the following:

    a. Excluding estimated returnable amounts would distort past trends of financial data where those amounts were previously included in revenue, and would result in lower revenue figures and profitability ratios.

    b. The guidance in the proposed Update may result in a lack of financial statement comparability due to the complexity and subjectivity in calculating insurance contract revenue.

    c. Significant costs, including systems development costs, would be incurred to enable reporting entities to track information to accurately remove estimated returnable amounts from revenue. Certain field testing participants noted that, currently, information about cash surrender values is not readily available and significant system updates would be required to obtain and track that information.

    d. There are concerns with the auditability of revenue recognition patterns.

121. One respondent recommended that the guidance in the proposed Update should only require reporting entities to exclude from revenue and expenses estimated returnable amounts that are explicit policyholder account balances included with certain contracts such as universal life contracts and variable annuity contracts. That is because policyholders are able to withdraw that balance immediately (regardless of whether a penalty is levied) without affecting the amount of coverage provided.

122. Some respondents noted that the requirement to exclude estimated returnable amounts from revenue and expenses would impact certain contract features such as dividend plans, which reporting entities use to attract or retain policyholders. Those dividend plans can be based on aggregate performance levels, and the amounts to be excluded from revenue would be difficult to estimate. Other respondents stated that the guidance in the proposed Update related to estimated returnable amounts may cause reporting entities to no longer include certain provisions in insurance contracts (for example, no-claims bonuses and rebate programs) because of the requirement to exclude those amounts from revenue. One respondent noted that excluding estimated returnable amounts from revenue would impact profitability ratios and stated that the likelihood of triggering an onerous contract liability by excluding those cash inflows from the onerous contract test would increase.

123. For health insurance contracts, many respondents and field testing participants were concerned with the requirement in the proposed Update to exclude estimated returnable amounts from revenue and were unsure about how the guidance would apply to certain health care reform provisions, such as minimum medical loss ratios, risk adjustments, and risk corridors. Those respondents recommended that the guidance in the proposed Update clarify how those premium adjustments should be accounted for to make certain that the proposed guidance is consistently applied as intended.

Participating Contracts

124. Most respondents generally agreed that participation features that are contractually dependent on the performance of other assets or liabilities of the insurer or the performance of the entity itself should be measured on the same basis used to measure those underlying items and presented in the same statements (that is, net income or OCI). The few respondents who disagreed supported extending the "mirroring" concept to discretionary participation features because contractual and discretionary participation features have the same characteristics (for example, the policyholder receives benefits in addition to guarantees) and, therefore, should be accounted for similarly. Additionally, bifurcating discretionary participation features and contractual participation features would be complex, would require modifications to existing accounting systems, and may result in diversity in practice. Some respondents also noted that policyholder account balances should be unbundled and reported separately as an investment component and the cash flows for items such as surrender fees, administrative fees, and the costs of insurance should be measured using the BBA with the margin unlocked for changes in cash flows due to changes in assumptions.

125. Several respondents recommended that the guidance in the proposed Update clarify the following:

    a. For modified coinsurance reinsurance contracts containing embedded derivatives, the embedded derivative would be separated from the host contract prior to applying the guidance in the proposed Update for participating contracts, and, therefore, the embedded derivative would not be measured on the same basis as the underlying items.

    b. The guidance for participating features would not apply to mutual insurance companies that issue property and casualty insurance contracts because of the lack of direct linkage between policies issued and the profit of the entity.

    c. The definition of contractually linked features should specify that the "mirroring" treatment should be limited to the values that can be represented as

a fixed percentage of the underlying items, because other drivers can dilute the direct linkage of such participating features.

126. One respondent who generally agreed noted that the guidance in the proposed Update for accounting for participating contracts would not eliminate all accounting mismatches since changes in unbundled cash flows related to embedded derivatives would be recognized through OCI. Other respondents recommended that the proposed Update should include more implementation guidance and that additional field testing should be conducted to properly understand the implications of the guidance in the proposed Update for participating contracts.

Reinsurance

Prohibiting Gain Recognition at Reinsurance Contract Issuance

127. While the majority of respondents agreed that a cedant should record a margin if the expected present value of the cedant's future cash inflows exceed the expected present value of the cedant's future cash outflows (thus prohibiting gain recognition at inception upon entering into a reinsurance arrangement), some respondents disagreed. Some respondents also agreed that the margin should exclude changes in the credit rating of the reinsurer, noting that a change in the credit rating of a reinsurer does not relate to future services.

128. Several respondents who disagreed that a cedant should establish a margin for reinsurance contracts noted that the guidance in the proposed Update would not properly reflect the economics of certain reinsurance agreements. For example, when a loss is recognized on the underlying insurance contracts at issuance, gains on the reinsurance contracts should be recognized up to the amount of the loss to eliminate accounting mismatches and to properly reflect the economics and the purpose of reinsurance in a reporting entity's financial statements. Additionally, if there is a gain at inception of the underlying contracts and a loss on the reinsurance contract, one respondent noted that the gain on the underlying contracts should be offset with the loss on the reinsurance contract, with any remaining gain being

deferred and recognized as margin. Some respondents disagreed with the immediate recognition of losses on ceded reinsurance contracts because a reporting entity often expects the cash outflows under a reinsurance contract to exceed its cash inflows, because it is willing to pay a premium to reduce uncertainty in the same way that other policyholders typically purchase insurance protection without an expectation of making a profit.

129. Several respondents also commented that the type of reinsurance agreement (for example, either proportional (quota-share) or nonproportional (excess of loss) contracts) should be considered when determining how the reinsurance acquired releases the cedant from risk and whether a gain should be recognized at inception of a reinsurance contract. Respondents generally agreed that the guidance in the proposed Update is appropriate for nonproportional contracts, because the nature of such contracts reflect different risks than the underlying contracts. For proportional contracts, a few respondents noted that gains and losses on ceded reinsurance should be recognized at inception of the contract in proportion to the risk ceded, because the contractual cash flows fully depend on the underlying direct insurance contracts held and in instances where the reinsurance pricing for proportional business is more favorable than the original pricing set by the cedant on the underlying business, the cedant has realized an economic gain that should be reflected in the financial statements at the inception of the reinsurance contract.

Measuring Fulfillment Cash Flows for Reinsurance Contracts

130. Most respondents generally agreed that a cedant should estimate the fulfillment cash flows (including the ceded premium) for a reinsurance contract using assumptions consistent with those used to measure the corresponding fulfillment cash flows for the underlying insurance contract(s), without reference to the margin. Some respondents noted, however, that a reporting entity should also consider the type of reinsurance contract (proportional versus nonproportional) when determining how to account for the reinsurance contract, consistent with paragraph 129 above. One respondent stated that for proportional contracts, a

reporting entity should reference the margin of the underlying contracts because the pricing of those contracts considers the profitability of the underlying contracts.

131. Several respondents recommended that the guidance in the proposed Update clarify the following:

    a. That "consistent" assumptions are not always required to be identical and that for some types of arrangements (for example, coinsurance), the assumptions should be identical, while for other types of arrangements (for example, yearly renewable term life or excess cession coverage), the terms of the reinsurance contract may not align with the terms of the underlying direct contracts and, therefore, using identical assumptions may not be appropriate

    b. Whether a reporting entity should apply the reinsurance contract guidance at the portfolio level or at the contract level.

Other Comments

132. Some respondents disagreed with the guidance in the proposed Update for accounting for reinsurance contracts because it would lower the threshold for risk transfer, allowing insurance treatment for contracts that do not expose the reinsurer to the possibility of a significant loss.

133. Certain respondents recommended that the guidance in the proposed Update for accounting for reinsurance contracts should include the following:

    a. A practical expedient for retrospective application of the proposed Update to in-force reinsurance agreements at transition, such as allowing the benefit of hindsight, because reinsurers have limited access to historical data for the underlying policies and would therefore have difficulty determining the margin at transition

    b. Additional implementation guidance for certain types of reinsurance contracts (for example, yearly renewable term contracts, excess of loss contracts, and aggregate loss on multi-year contracts) accounted for using the BBA and the PAA

c. Clarification that the release of the margin on reinsurance contracts should align with the underlying insurance contracts to appropriately reflect the economics of the reinsurance transaction.

Insurance Contracts Acquired in a Business Combination

134. Most respondents disagreed that a reporting entity should record a loss at the acquisition date if the present value of fulfillment cash flows measured in accordance with the guidance in the proposed Update exceeds the fair value of the insurance contracts. Those respondents stated that instead of introducing industry-specific guidance, it would be more appropriate to follow the principles in Topic 805, Business Combinations, and that recording a loss would not reflect the economics of the transaction. Substantially all respondents who disagreed that a reporting entity should record a loss at the acquisition date support a requirement to adjust goodwill for the differences between the fair value and the measurement of those assets and liabilities in accordance with the guidance in the proposed Update, which is consistent with the guidance in the IASB Exposure Draft.

135. Several respondents commented on the complexity of the guidance in the proposed Update on business combinations, noting that (a) the calculations to determine the discounted fulfillment cash flows and the fair value of the liability under existing purchase accounting on the date of the acquisition would be complex and (b) the guidance in the proposed Update may only be practical for the acquisition of a line of business and not for the acquisition of an entire business.

136. Most respondents agreed that a reporting entity should record a margin (not an immediate gain) for the amount that the fair value of the asset and liability balances exceeds those assets and liabilities measured in accordance with the guidance in this proposed Update, because that would be conceptually similar to recording a separate intangible asset under Topic 805. Two respondents recommended that the guidance in this proposed Update specify how a reporting entity should present the components of insurance contract assets and liabilities for contracts acquired that would be accounted for using the PAA.

137. Two respondents disagreed that a reporting entity should record an immediate loss in net income for a portfolio transfer if the fulfillment cash outflows exceed the fulfillment cash inflows at the time of the transfer.

Contract Modifications

138. Many respondents generally agreed that for a substantial modification (a) a reporting entity should recognize a gain or loss as the difference between the measurement of the modified contract using the current entity-specific price that the reporting entity would hypothetically charge the policyholder for a contract equivalent to the new contract and the carrying amount of the existing contract and (b) the carrying amount of the existing contract should be derecognized. Many respondents also disagreed. Those respondents who disagreed and some respondents who generally agreed noted that eliminating key aspects of existing U.S. GAAP guidance on accounting for contract modifications (for example, guidance related to integrated and nonintegrated features and certain application guidance) while retaining others increases the complexity of the guidance in the proposed Update.

139. Many respondents also noted that an unlocked margin would simplify the guidance in the proposed Update for contract modifications by eliminating the differences between a substantial and a nonsubstantial modification. With an unlocked margin, changes from both substantial and nonsubstantial contract modifications would be recognized in the margin, making the distinction less important. Another respondent commented that elimination of capitalized direct acquisition costs as a component of the margin also would eliminate the need for specific contract modification guidance to account for treatment of direct acquisition costs.

140. A few respondents who disagreed supported the requirement in the IASB Exposure Draft to treat a modified contract as a new contract if either of the following conditions are met:

    a. The contract no longer meets the definition of an insurance contract

b. The contract no longer meets the criteria to stay in the same portfolio of insurance contracts.

141. Certain respondents were concerned that reporting entities would interpret the meaning of a "substantial modification" differently. Other respondents were concerned with the complexity of applying the guidance in the proposed Update on contract modifications to individual contracts when other cash flows are accounted for at the portfolio level. Finally, some respondents were concerned about the complexity of calculating a hypothetical price that generates a gain or a loss.

142. Some respondents recommended that the guidance in the proposed Update clarify the meaning of a "substantial modification" and whether certain options in an insurance contract (for example, an insurer's right to increase premiums charged) are contract modifications or are part of the initial calculation of fulfillment cash flows. Certain respondents also recommended that substantially changed contracts should be assigned to a new portfolio and that any margin (and deferred acquisition costs) attributable to the old contract should be eliminated upon remeasurement of the exited portfolio. That would eliminate the need to track the margin at a unit of account that is less than the portfolio level while largely achieving the same result.

Presentation

143. Most respondents disagreed with the various presentation requirements included in the proposed Update. Overall, those respondents noted that the proposed presentation requirements would do the following:

a. Increase financial statement volatility

b. Create excessively detailed financial statements by requiring separate presentation of insurance contracts accounted for using the BBA and PAA

c. Require preparers to educate users about the financial statement changes

d. Not appropriately capture the economics of an insurance entity's business

e. Reduce financial statement comparability between insurers and other financial services entities

f. Drive investment capital away from the insurance industry

g. Be costly to implement.

Retaining Existing U.S. GAAP Presentation Requirements

144. Numerous respondents who disagreed with the presentation requirements in the proposed Update supported retaining the existing U.S. GAAP presentation requirements for short-duration contracts, because that presentation is well understood by users and preparers and has been time tested through numerous economic and insurance cycles. Some respondents also supported retaining the existing U.S. GAAP presentation requirements for separate accounts, where the investment performance of separate accounts is offset against the corresponding amounts credited to contract holders in the same line item on the statement of comprehensive income.

Regulation S-X

145. A few respondents noted that the presentation requirements in the proposed Update are not consistent with the existing presentation requirements for financial statements filed with the Securities and Exchange Commission (SEC) contained in Article 7 of Regulation S-X, *Insurance Companies*. Those respondents also noted that Article 7 of Regulation S-X only applies to insurance entities and not to other entities issuing insurance contracts. Those respondents recommended that the presentation guidance in the proposed Update and the requirements in Regulation S-X should be aligned prior to the effective date of the guidance in the proposed Update.

Ceding Commission Presentation

146. Some respondents disagreed that ceding commissions should be recognized as a reduction of ceded premiums and recommended retaining the existing U.S. GAAP guidance that requires ceding commissions to be recognized as a reduction of acquisition costs. Some respondents noted that ceding commissions represent a

recovery of acquisition costs incurred during the issuance of the direct/underlying contracts, and recognizing ceding commissions as a reduction of acquisition costs more accurately reflects the economics of reinsurance transactions. Other respondents recommended that ceding commissions should be presented on a gross basis to promote financial statement comparability among ceding entities and assuming entities and so that the financial statements are more transparent and understandable to financial statement users. Several respondents noted that ceding commissions should be reported as a reduction to other underwriting expense. Overall, some respondents were concerned that the requirement in the proposed Update to recognize ceding commissions as a reduction of ceded premiums would distort key performance metrics (for example, the combined ratio) that analysts use to evaluate reinsurance entities.

147. Certain respondents noted that the requirement in the proposed Update to recognize ceding commissions as a reduction of ceded premium also would create presentation issues for fronting arrangements in which 100 percent of the business is ceded and no risk is retained by the ceding entity. Because gross premiums and ceded premiums would be presented on a net basis, total premium for fronting arrangements would equal zero before recognizing ceding commissions as a reduction of ceded premium.

Summarized Margin Approach

148. A few respondents suggested that the guidance in the proposed Update require the summarized margin approach originally proposed in the 2010 Discussion Paper. Those respondents noted that the summarized margin approach would appropriately reflect cash inflows in revenue and present decision-useful information about volume information and the actual consideration received for financial statement users. Some respondents stated that financial statement users would disregard revenue calculated using the guidance in the proposed Update because it would be difficult to understand and it would not provide a meaningful measurement. Reporting entities would then be required to provide users with

decision-useful information through supplemental non-GAAP schedules and disclosures.

Presenting Interest Accretion in Interest Expense

149. Several respondents generally disagreed that a reporting entity should present interest accretion on the discounted insurance contract liabilities in interest expense and stated that discounting the insurance contract liabilities is an underwriting activity and should be reported as part of underwriting income. A few respondents noted that the presentation requirements in the proposed Update for interest accretion could result in insurers renegotiating bank covenants with financial institutions. Other respondents noted that existing U.S. GAAP does not require a reporting entity to present the impact of interest accretion in interest expense, and reporting entities accrete interest on other liabilities (for example, pension liabilities) and do not present that interest accretion in interest expense.

Disclosure

150. Many respondents agreed with the overall objective of the disclosure requirements to enable users of financial statements to understand the amount, timing, and uncertainty of future cash flows arising from insurance contracts. However, many respondents generally disagreed with the disclosure requirements included in the proposed Update and noted that the required disclosures are voluminous, would be costly to implement, would be operationally burdensome, would be difficult to audit, and would not provide users with decision-useful information.

151. Certain respondents generally supported the requirement to disclose reconciliations from the opening to the closing balances of the insurance-related balances separately for contracts measured using the BBA and PAA. Those respondents noted that these reconciliations will provide financial statement users with sufficient information without being a burden. Respondents also generally supported the disclosures of discount rates and expected cash flows in multiple time bands along with the weighted-average discount rates used to determine the

measurement of the expected fulfillment cash flows. However, respondents noted that both disclosures should be reported at the segment level, in a manner consistent with how entities operate and manage their business.

152. Many property and casualty insurance respondents and some users supported including an undiscounted claims development table to provide users with information to better understand an insurer's ability to properly underwrite and anticipate claims. In addition, some preparers stated that an undiscounted claims development table can be prepared without significant additional costs or complexity, as it is currently prepared for statutory reporting purposes.

SEC Reporting Requirements

153. Many respondents who generally disagreed with the disclosure requirements noted that the disclosure requirements in the proposed Update are similar to some disclosures required by SEC reporting rules, and reporting entities already include those disclosures in Item 1A, *Risk Factors*, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and Item 7A, *Quantitative and Qualitative Disclosures about Market Risk*, of the annual report on Form 10-K. Disclosures included in the notes to financial statements would not be subject to the safe harbor rules, but would be subject to the internal control requirements of Sarbanes-Oxley Section 404.

Dividends for Participating Contracts

154. Many respondents were concerned that disclosing the present value of expected dividends to policyholders for participating contracts would not be decision useful and would give rise to inappropriate expectations by policyholders and others, because discretionary dividends are projected many years or decades into the future, depend upon numerous factors (for example, general economic conditions, investment returns, and mortality and expense experience), and are not finalized until approved by a reporting entity's board of directors.

Sensitivity Disclosures

155. Many respondents disagreed with the proposed sensitivity disclosures and stated that the analysis creates information that can be misapplied, misunderstood, and may require entities to disclose proprietary information. A portion of those respondents noted that the sensitivity disclosure requirements in the proposed Update would imply that there is a range around the insurance contracts balances and any amount within that range would be a reasonable substitute for the amount reported. Respondents recommended that reporting entities only provide high-level, qualitative sensitivity disclosures so that the information will be useful to and easily understood by the users of the financial statements. Some respondents also recommended that sensitivity disclosures should be separately provided for contracts accounted for using the PAA and the BBA.

Disaggregation

156. Certain respondents stated that the guidance in the proposed Update does not clearly prescribe the level of disaggregation required for disclosures (for example, whether disclosures should be prepared at the group level, operating unit level, or at the portfolio level). Many preparers noted that disclosing information at the portfolio level would be costly and burdensome, may not be transparent for users, and would therefore not be decision useful.

Non-GAAP Disclosures

157. Many preparers and users noted that the disclosure requirements in the proposed Update would result in reporting entities providing additional non-GAAP information to users, because users will require the net premiums written unaffected by the revised treatments of ceding commissions, investment income that does not reflect the impact of discounting, and operating earnings that do not include the probability of catastrophes. Some respondents also stated that the disclosure requirements in the proposed Update may lead analysts or investors to

focus primarily on statutory accounting reports and to ask insurers to report non-GAAP results.

Effective Date and Transition

Key Drivers Affecting Implementation Timing

158. Most property and casualty insurance entity respondents commented that the primary drivers affecting implementation timing would be the following:

    a. Discounting the liability for incurred claims

    b. Calculating the unbiased, probability-weighted cash flow estimates

    c. Using the definition of a portfolio in the proposed Update

    d. The inability to use hindsight when determining appropriate assumptions for transition.

159. Property and casualty insurance entities mentioned other drivers that would affect implementation timing including accounting for direct acquisitions costs, unbundling, disclosure requirements, estimated returnable amounts, onerous contract test, and determining whether contracts should be accounted for using the BBA or the PAA.

160. Life insurance entities commented that the primary drivers affecting implementation timing would be the following:

    a. Retrospective application of the guidance in the proposed Update, including determining the appropriate assumptions for policies that were issued decades in the past

    b. Determining the discount rates and discounting the insurance contract assets and liabilities

161. Life insurance entities mentioned other drivers that would affect implementation timing, including using the definition of a portfolio in the proposed Update, accounting for estimated returnable amounts, performing the onerous contract test,

and determining whether contracts should be accounted for using the BBA or the PAA.

162. Other respondents (including other insurance companies, noninsurance entities, and auditors) also indicated that retrospective transition, discounting, and using the definition of a portfolio in the proposed Update were the primary drivers affecting implementation timing.

163. Many respondents also commented that in addition to the above, significant systems development and new internal control processes and procedures would be needed for proper data gathering and data management. Hiring and training additional accounting, actuarial, and other personnel (either internally or by engaging consultants) also would affect implementation timing, and additional effort would be undertaken to educate various stakeholders including management, board members, investors, rating agencies, and creditors.

164. Many respondents noted that aligning the effective date of the guidance in the proposed Update on insurance with the effective date of the guidance in the proposed Update on financial instruments with the effective date of the IASB Exposure Draft is critical. Some respondents also noted that implementing the guidance in the proposed Update would require changes to other aspects of an entity's business, including performance management and metrics, product design, and regulatory reporting.

165. Based on the factors mentioned above, respondents' estimation for implementation timing was varied, ranging from three to eight years. The average amount of time respondents requested after the issuance date of the final standard was four to five years. Many respondents stated that with certain recommended changes to the primary drivers noted above, implementation time could be significantly reduced.

Nonpublic Entity Considerations

166. Many respondents noted that the effective date for nonpublic entities should be one year later than the effective date for public entities because nonpublic entities need additional time due to resource constraints and often learn from public entities'

financial statements. However, many other respondents noted that the adoption date should be the same for all entities that issue insurance contracts because a single adoption date would result in less confusion for both investors and preparers, especially as it relates to historical financial statements. Some of those respondents recommended that the limited resources of nonpublic entities should be considered when determining a single effective date.

167. A few respondents recommended that noninsurance entities should be given additional time to adopt the guidance in the proposed Update regardless of whether they are public entities or nonpublic entities.

Practical Expedient

168. A majority of respondents disagreed with the practical expedients for transition in the proposed Update; however, those respondents agreed that the guidance in the proposed Update should be applied retrospectively. Some respondents noted that retrospective application difficulties would include performing the onerous contract test, accounting for contract modifications, amortizing the margin on the basis of actual experience, and accounting for participating contracts.

169. Some respondents commented that allowing entities to calculate a margin incorporating hindsight at transition is better than defaulting to a margin of zero in cases in which objective evidence is not available. Those respondents argued that using historical assumptions would be significantly complex and costly while providing little benefit to users.

170. Some respondents supported an unlocked margin as the best practical expedient and stated that unlocking the margin would significantly reduce the implementation complexity by using current transition date assumptions instead of historical assumptions.

171. Some respondents recommended that the guidance in the proposed Update should include an additional practical expedient or exemption from retrospective transition for sales of businesses and for contracts that are 100 percent reinsured prior to the effective date of the guidance in the proposed Update. Respondents stated that

determining fulfillment cash flows and the appropriate discounting for prior periods for those transactions would be costly and impracticable because the reporting entity will not have access to the appropriate data, systems, and employees.

Costs and Complexities

General

172. Many respondents commented on the costs and complexities of adopting the guidance in the proposed Update and noted that significant costs would be incurred mainly due to the following:

    a. A*pplying the definition of a portfolio.* Many respondents noted that the definition of a portfolio would contribute the most to the costs required to adopt the guidance in the proposed Update. Most field testing participants also commented that that the portfolio definition would result in a significant number of portfolios, which would require more processing time for quarterly and annual reporting along with changes to accounting and reporting systems and more resources.

    b. *Personnel costs.* The majority of respondents noted that significant additional costs would be incurred to educate, train, and hire additional internal personnel to apply the various aspects of the guidance in the proposed Update. Those costs would be incurred by various departments within a reporting entity's organization including but not limited to accounting, finance, actuarial, management, and information technology. In addition, the resources needed to educate and train external stakeholders, such as investors and analysts, would be significant due to the new financial statement presentation and significant new required disclosures. Respondents noted that those costs would be significant for initial implementation as well for ongoing compliance with the guidance in the proposed Update.

c. *Disclosures.* Many preparers were concerned about the costs to comply with the significant volume of detailed disclosure requirements and the impact that the required disclosures would have on the quarterly and annual closing process. Those respondents also noted that reporting systems would need to be developed or modified to compile and analyze the required disclosures.

d. *Compliance with Sarbanes-Oxley Section 404 Requirements.* Many respondents commented that reporting entities would need to implement or modify the actuarial, accounting, and reporting systems necessary to comply with the guidance in the proposed Update. That would result in reporting entities adding and/or modifying internal control processes and procedures to comply with Sarbanes-Oxley Section 404, which would increase internal costs and external audit fees. Several auditors commented that auditing (1) the transition adjustment, (2) the initial and ongoing identification of portfolios, (3) the selection of the appropriate measurement model, and (4) assumption updates each reporting period will significantly increase audit costs.

Interaction with IFRS, Statutory Accounting Principles, and Other Active Projects

173. Some respondents that would be required to report under both U.S. GAAP and IFRS noted that there would be significant costs incurred and increased complexity of implementing two different accounting standards. Those respondents noted that convergence or closer alignment of the guidance in the proposed Update and the IASB Exposure Draft would reduce the costs of implementing and maintaining multiple systems.

174. Several respondents also noted that differences between statutory accounting principles and the guidance in the proposed Update for the measurement of loss reserves would significantly contribute to a reporting entity's overall costs to comply with the various accounting requirements. Although there are differences between existing U.S. GAAP and statutory accounting principles today, the differences would be more significant if the guidance in the proposed Update is finalized as currently written. Reporting entities would need to develop or purchase

new actuarial and accounting systems to maintain the information necessary to comply with both the guidance in the proposed Update and statutory accounting principles.

175. A few respondents commented that aligning the effective dates of the guidance in the proposed Update on insurance and the guidance in the proposed Update on financial instruments would increase efficiency and reduce the costs of updating accounting and reporting systems and internal control processes. Those respondents stated that aligning the effective dates would help users understand complex changes to financial statements all at one time.

Short-Duration Contracts

176. The majority of property and casualty insurance entity respondents noted that the most costs will be incurred to implement new methodologies and systems to discount the liability for incurred claims and to calculate the unbiased, probability-weighted estimates of cash flows. Most of those respondents explained that current accounting and reporting systems are not capable of calculating and tracking discount rates for portfolios of insurance contracts and that the proposed definition of a portfolio would add to the complexity of the calculation. Those respondents also noted that significant costs would be incurred to drastically change the reserving process and to capture the data necessary to produce the unbiased, probability-weighted discounted fulfillment cash flows required by the guidance in the proposed Update.

Long-Duration Contracts

177. The majority of life insurance entity respondents indicated that significant costs would be incurred to apply the discount rate methodology, to lock the margin at inception of a contract, and to update assumptions each reporting period. Those respondents noted that calculating a discount rate that reflects the characteristics of the liability and updating the discount rate each period are the most complex aspects of the guidance in the proposed Update and would cause reporting entities

to incur significant costs. Some respondents also noted that locking in the margin at contract inception is complex and costly due to calculation of an appropriate amortization pattern over the period a reporting entity is released from risk.

178. Health insurance entity respondents noted that the guidance in the proposed Update requiring reporting entities to exclude estimated returnable amounts from revenue would be costly and complex to implement, specifically when related to experience-rated group health contracts. Costs would include building and maintaining accounting and reporting systems to gather and retain data and exclude the correct amount from revenues and expenses.

Noninsurance Entities

179. Some noninsurance entity respondents (mainly financial institutions) noted that reporting entities would incur significant costs to determine the contracts that would be included within the scope of the proposed Update. Most contracts, such as standby letters of credit, have unique terms for each customer and will require individual analysis to determine whether they transfer significant insurance risk. Specifically, it will be costly to assess the underwriting risk for contracts such as indemnities, letters of credit, and minimum revenue guarantees since reporting entities often do not collect premiums or commissions for those instruments.

Appendix A—Field Testing Results Issues Summary

A1. Field testing participants were concerned with the operationality of certain aspects of the guidance in the proposed Update. The following is a summary of the significant areas discussed during field testing results meetings:

Area	Life				Property & Casualty				Health		Reinsurance		Other Insurance		Noninsurance			
	A	B	C	D	A	B	C	D	A	B	A	B	A	B	A	B	C	D
Scope														✓	✓	✓	✓	✓
Separating components of an insurance contract	✓			✓						✓					✓			
Estimated returnable amounts and loss sensitive features			✓		✓		✓	✓	✓	✓								
Determining the model						✓	✓	✓		✓	✓	✓		✓	✓		✓	✓
Definition of a portfolio	✓		✓	✓	✓		✓	✓	✓	✓	✓	✓					✓	
Contract boundary					✓					✓		✓						
Probability-weighted estimates					✓	✓	✓	✓	✓	✓				✓				
Discount rate and discounting	✓	✓	✓	✓	✓	✓	✓	✓	✓		✓		✓	✓				
Unlocking the margin	✓	✓	✓	✓					✓			✓	✓					
Revenue recognition		✓	✓				✓	✓	✓	✓	✓	✓	✓	✓				
Presentation and disclosures	✓	✓	✓	✓			✓	✓	✓		✓	✓	✓	✓			✓	
Deferred acquisition costs			✓		✓		✓					✓						
Onerous contract test	✓	✓	✓			✓		✓			✓	✓	✓				✓	
Business combinations					✓													
Foreign currency											✓		✓					
Transition		✓										✓						
Costs and complexity	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓