AMERICAN ACADEMY *of* ACTUARIES

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December 23, 2014

Joanna Yeoh
Senior Technical Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: IASB and the Academy's November 24th Conference Call on Participating Contracts

Dear Joanna,

On behalf of the American Academy of Actuaries'[1] Financial Reporting Committee, I would like to provide the following written comments in response to your questions on the International Accounting Standards Board's (IASB) treatment of participating contracts in its insurance contracts project. They are intended to supplement the Nov. 24 conference call between representatives of the IASB and our committee. We hope you will take them into consideration as the Board moves to finalize its decisions on participating contracts.

In response to your question about the appropriate order of calculation of other comprehensive income (OCI) and contractual service margin (CSM) unlocking, each component can be calculated independently regardless of order.

There is at least one circumstance, however, that should be addressed under the effective yield approach under which there could be some interaction between the CSM and OCI. This is a situation in which there is a minimum interest guarantee that is in-the-money or is expected to come into the money. There are two ways to address credited rates in this situation:

- Reset the effective yield used for discounting the liability for profit and loss (P&L) based on the actual credited rate. When the guarantee applies, this would not result in a change to the discount rate applied to cash flows during these periods. In this case, the effect of the guarantee should be reported in OCI.

- Update the discount rate that is used to determine the liability for P&L, based on the credited rate that would have been applied if the minimum guarantee was not in effect. In this circumstance, the change in projected cash flows resulting from the difference

[1] The American Academy of Actuaries is an 18,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

between the guaranteed rate and the credited rate, which would have applied if not for the floor, should be reflected in the CSM (assuming the CSM is positive). This approach would allow reporting entities that do not use OCI to report the effect of the guarantee in future cash flows in the CSM, consistent with reports that use OCI. It also would put the effect of the guarantee in P&L if the CSM has been exhausted.

The question about realized gains and losses could be addressed by amortizing the gain/loss over the remaining life of the sold asset. Under U.S. regulatory reporting, for example, a similar amortization process is followed by the use of a distinct interest maintenance reserve. Realized gains and losses resulting from selling assets, where the gain or loss was the result of interest rate changes, are capitalized in this reserve as long as the reserve is in a liability position. The reserve is then amortized over time. Although this approach is not used in all jurisdictions,[2] the methodology can be used to effectively treat the reporting of gains and losses through current P&L in cases in which those gains and losses will be passed through to policyholders through future adjustments to credited rates.

Separately, in light of recent developments discussed below, the committee has reconsidered the relative suitability of an effective yield approach versus a book yield approach for determining OCI for participating contracts. After consideration, we believe that the book yield approach with a fully unlocked CSM, including for reinvestment risk, would be preferable to an effective yield approach. This contrasts with our initial response to the exposure draft in which the committee recommended an effective yield approach. At that time, we did not think the Board would accept an asset-based discount rate. In addition, International Financial Reporting Standard (IFRS) 9 restricted the use of fair value (FV)-OCI and amortized cost for financial assets in more situations than we had expected. Since the CFO Forum elaborated on the book yield methodology in a manner that we expect to be practical and the Board appears willing to consider an asset-based discount rate, the book yield approach should avoid accounting mismatches with FV-P&L assets, provide more consistent valuing of assets and liabilities, and address the offset to realized capital gains and losses. As a result, the book yield approach should lead to more meaningful financial reporting, outweighing the potential benefits of an effective yield approach.

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Thank you for this opportunity to provide additional feedback on the IASB's participating contracts considerations. If you have any questions or would like to discuss these issues in more detail, please contact Lauren Sarper, the Academy's senior policy analyst for risk management and financial reporting, at 202.223.8196 or sarper@actuary.org.

Sincerely,

Leonard Reback, MAAA, FSA
Chairperson, Financial Reporting Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries

[2] Even in the United States it is limited to situations in which net gains have been realized, resulting in a liability.