AMERICAN ACADEMY *of* ACTUARIES

September 26, 2012

Financial Accounting Standards Board (FASB)
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Comments on *Proposed Accounting Standards Update Financial Instruments (Topic 825) - Disclosures about Liquidity Risk and Interest Rate Risk*

On behalf of the American Academy of Actuaries'[1] Financial Reporting Committee I offer the attached comments on the FASB Exposure Draft on Liquidity Risk and Interest Rate Risk Disclosures (ED).

If you have any questions, please submit them to Tina Getachew, senior policy analyst, Risk Management and Financial Reporting Council, by phone (202-223-8196) or email (getachew@actuary.org).

Sincerely,

William C. Hines
Chairperson, Financial Reporting Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries

[1] The American Academy of Actuaries is 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policy-makers 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 actuarial in the United States.

General Comments:

We are responding primarily regarding how these proposed amendments would affect insurance companies and their stakeholders. The nature of insurance is to manage risk and uncertainty. Insurance contracts by their terms subject insurers to uncertainty in the amount and timing of the cash flows they take in and pay out. The uncertainty results from many risks taken on by insurers including, but not limited to, claim frequency, claim severity, policyholder behavior, credit and reinvestment, expense management and operational risks. Stakeholders are interested in insurers' exposure to all of these risks and how the companies manage them. We believe it would be most useful to develop a comprehensive set of disclosures that focuses on the significant risks to which insurers are subject rather than the narrow focus of the proposed disclosures on liquidity and interest rate risks.

On their own, any tables such as those proposed are likely to be misinterpreted even by knowledgeable users. Considerable narrative disclosure will be needed to explain the meaning of each of these tables, even if modified as suggested below. This will make preparing the information expensive and time consuming for insurers.

We believe that some of the proposed disclosures could be seen as "forward-looking statements" as defined by the Securities and Exchange Commission (SEC). Since these disclosures will be part of the financial statement requirements under US GAAP, preparers will likely need to include additional cautionary statements in the disclosure itself identifying important factors that could cause actual results to differ materially from those in the forward-looking statement (i.e., disclosure).

Responses to Questions

We provide responses to questions directed at preparers and auditors.

Question 1: ***For a financial institution, the proposed amendments would require a liquidity gap table that includes the expected maturities of an entity's financial assets and financial liabilities. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?***

We believe that there are several issues with this requirement.

We do not believe that providing an estimate of a single maturity date provides useful information regarding the liquidity risk of insurance contracts. We believe that instead of using expected cash flows as an indicator of a maturity date or using the carrying value as the amount implied to be subject to liquidity risk, the more relevant measure of liquidity for insurance contracts would be expected cash flows themselves. We believe it is also more relevant to present expected cash flows of financial assets.

The ED defines expected maturity as "the expected settlement of the instrument resulting from contractual terms (for example, call dates, put dates, maturity dates, and prepayment expectations) rather than the entity's expected timing of the sale or transfer of the instrument." Paragraph 825-10-55-5A g. states "For insurance liabilities, a reporting entity's expectation of the timing of the payout of the liabilities, which could be multiple for a single contract, should be a consideration in the expected maturity estimate." Some of our members believe these paragraphs imply that a single maturity date is to be defined even when multiple cash flows are expected to be paid. Identifying a single date for a contract that expects to pay benefits at multiple dates does not help to provide useful information on liquidity. For many contracts defining a maturity date, whether a single date or multiple dates, is at best difficult and at worst impossible to do. An example of such a contract is an annuity that provides a regular payment to the contract holder as long as the annuitant remains alive in return for a single premium. This type of contract is often referred to as a single premium immediate annuity. Since payments are made as long as the annuitant is alive, there is no way to determine a maturity date for the contract.

The requirement to identify the carrying values by maturity date obfuscates the potential liquidity risk for insurance contracts where the carrying value is equal to a discounted present value of expected future cash flows. It is the cash flows themselves, not the present value of them, that need to be made with liquid funds. For long term contracts such as the immediate annuity noted above and many life insurance contracts, the payments to be made under the contract are expected to be so far into the future that the current (discounted) value of them is significantly less than the expected actual payments to be made. Using the current carrying value as a proxy for the liquidity needs may be misleading.

Liability cash flows should include all expected cash flows such as non-guaranteed payments and be net of premiums paid. Asset cash flows should include the expected investment income that will be earned as this is relevant to managing liquidity risk.

Question 3: ***The proposed amendments would require information about expected maturities for financial assets and financial liabilities to highlight liquidity risk. "Expected maturity" is the expected settlement of the instrument resulting from contractual terms (for example, call dates, put dates, maturity dates, and prepayment expectations) rather than an entity's expected timing of the sale or transfer of the instrument. Do you agree that the term expected maturity is more meaningful than the term contractual maturity in the context of the proposed liquidity disclosures? If not, please explain the reasons and suggest an alternative approach.***

As we noted in our response to question 1, the term expected maturity is not meaningful for insurance liabilities. We believe that a better approach would be for this table to show expected cash flows of all types. Discounting should be ignored for this purpose. This is the basis on which management and regulators typically look at this issue.

Question 4: ***The proposed amendments would require a quantitative disclosure of an entity's available liquid funds, as discussed in paragraphs 825-10-50-23S through 50-23V. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?***

We see no operational concerns with complying with this requirement.

Question 6: ***As a preparer, do you feel that the proposed amendments would provide sufficient information for users of your financial statements to develop an understanding or your entity's exposure to liquidity risk? If not, what other information would better achieve this objective?***

We believe the proposed amendments will not provide sufficient information for users to develop an understanding of an entity's liquidity risk. The proposed amendment requires disclosure of the current carrying value of an entity's asset and liabilities by expected maturity date. We believe that disclosing expected future cash flows would be more relevant to the liquidity needs of insurers.

The carrying value of most insurance contracts is either the discounted value of or sum of expected future net cash flows. For insurance contracts with benefit expected to occur many years after the date of the financial statement, the carrying value may be significantly lower than the cash flows expected to be paid under the contract, giving the mistaken impression that little liquidity risk exists.

Uncertainty as to the amount and/or timing of future cash flows to be realized under the contract is a distinguishing feature of insurance contracts. Identifying a single "expected maturity" date as the relevant measure of liquidity of an insurance contract does not recognize the potential for cash flows to occur at alternative dates or at multiple dates in the future. We believe there is a need for additional information regarding the potential risk of actual cash flows deviating from the expected cash flows that would be disclosed. This should include the assumptions used to generate the expected cash flows that are disclosed, a description of the risks that exist that contribute to the uncertainty in the projected cash flows and how management manages those risks as well as a description of management alternatives that would be needed for situations where there is a mismatch of asset and liability cash flows. These comments would likely be lengthy and very technically complex.

Question 13: ***The interest rate risk disclosures in this proposed Update would require a repricing gap table. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?***

We believe there are significant operational difficulties in producing this table. The required repricing gap table is based on the assumption that there is a contractual interest rate defined for each insurance contract and that it may be periodically repriced. Few insurance contracts have an explicit crediting of interest to a contract balance. The vast majority of insurance contracts only define a premium and the benefit to be paid if an insured event occurs during the coverage period. How this table would be prepared for these contracts is very unclear. The questions it attempts to answer, how well a company is matched and how sensitive it is to interest rate movements, seem to be better addressed by the other disclosures required in this section.

Question 14: ***The interest rate risk disclosures in this proposed Update would include a sensitivity analysis of net income and shareholder's equity. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?***

We believe that these sensitivities will require significant additional costs and effort to implement.

The table shows the effect of a change in future interest rates on the date of reporting. There would be several types of effects.

First, for certain types of policies issued in the current year, it would require an additional calculation of liabilities using the different discount and credit rates. This would be very time-consuming. For products where the amortization of certain items are in proportion to gross or net revenues (such as Deferred Acquisition Cost (DAC) assets, Unearned Revenue Liabilities (URL) and additional liabilities established for bonuses and guarantees), these items would need to be recalculated for each different scenario. For this recalculation, the company would need to decide on different discretionary actions as a result of the change in scenario. Again this would be very time-consuming and resource demanding.

Second, the sensitivity analysis requires projection of net income for the 12-month period immediately after the reporting date. Paragraph 825-10-50-23AF states that the reporting entity "should not incorporate any forward-looking expectations regarding non-interest revenues, non-interest expenses, tax rates, projections about growth rates, asset mix changes, or other internal business strategies in preparing the interest rate sensitivity analysis." It is not clear to us how net income would be calculated for the 12-month period if assumptions regarding the entity's performance over the next 12 months are not to be taken into account.

We note that similar sensitivities to changes in interest rates are currently required annually by state regulators of life insurance companies. These sensitivities and an accompanying report are due two months after the financial statement date. Even with this two-month time-frame to complete, regulators have found it necessary to allow insurers to perform their testing as of one-quarter year earlier to allow the companies sufficient time to complete and validate the testing and prepare the appropriate documentation. To accelerate this effort and to require it be completed within the time period needed to complete a US GAAP statement would be a significant burden for companies that already are used to doing this for regulators. It will be an even larger burden for companies not used to producing such sensitivities.

Question 15: ***As a preparer, do you feel that the proposed amendments would provide sufficient information for users of your financial statements to understand your entity's exposure to interest rate risk? If not, what other information would better achieve this objective?***

Insurance contracts by their nature subject insurers to uncertainty in the amount and timing of the cash flows they take in and pay out. The uncertainty results from many risks taken on by insurers including, but not limited to, claim frequency, claim severity, policyholder behavior, credit and reinvestment, expense management and operational risks. Stakeholders are interested in insurers' exposure to all of these risks and how the companies manage them. We believe it would be most useful to develop a set of disclosures that focuses on the most significant risks to which insurers are subject rather than the narrow focus of the proposed disclosures on liquidity and interest rate risks.

If better defined this could be a useful disclosure.

Question 20: ***The amendments in this proposed Update would apply to all entities. Are there any entities, such as nonpublic entities, that should not be within the scope of this Update? If yes, please identify the entities and explain why.***

We agree that disclosures regarding liquidity and interest rate risk should apply to all entities. There are many non-publicly traded entities such as credit unions, mutual insurance companies, and non-profit entities that owe a fiduciary duty to their stakeholders. These stakeholders would be equally interested in such disclosures.

Question 21: ***Although the proposed amendments do not have an effective date, the Board intends to address the needs of users of financial statements for more information about liquidity risk and interest rate risk. Therefore, the Board will strive to make these proposed amendments effective on a timely basis. How much time do you think stakeholders would require to prepare for and implement the amendments in this proposed Update? Should nonpublic entities be provided with a delayed effective date? If so, how long of a delay should be permitted and why? Are there specific amendments that would require more time to implement than others? If so, please identify which ones and explain why.***

As we mentioned in the answers to the above questions we believe these disclosures, in particular the sensitivity tests required as part of the interest rate disclosures, will require a very significant effort for insurers to implement so that they can be produced at the same time as the US GAAP financial statements. We believe several years could be needed for implementation.