AMERICAN ACADEMY *of* ACTUARIES

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September 21, 2020

Ms. Kim Kushmerick
Associate Director
AICPA
1345 Avenue of the Americas, 27th Floor
New York, NY 10105

Dear Ms. Kushmerick,

On behalf of the American Academy of Actuaries[1] Financial Reporting Committee of the Risk Management and Financial Reporting Council ("the Committee"), I would like to provide the following comments on the July 24 Working Draft — Targeted Improvements to Long-Duration Contracts Implementation Issue 11AC (ceded reinsurance) — wording to be included in the *Audit and Accounting Guide: Life and Health Insurance Entities*.

Overall, the Committee believes this will be a valuable addition to the guide and has no disagreement with any of the conclusions as we understand them. We are concerned, however, that there may be some confusion about the relationship between paragraphs 10 and 11.

The last sentence in paragraph 10 concludes that "in a situation where the insurer calculates a direct liability less than zero … and as a result … floors that balance at zero, the insurer should generally … floor the reinsurance recoverable asset at zero as well." Paragraph 11 then begins "However, there may be certain fact patterns where the recognition of a liability … may be appropriate."

Taken together, we see two unambiguous circumstances here:

- When the "fact patterns" of paragraph 11 do not exist and the "situation" of paragraph 10 does occur, then the reinsurance recoverable is also floored.
- When the "fact patterns" of paragraph 11 do exist and the "situation" of paragraph 10 does not occur, then the reinsurance recoverable is not floored.

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted 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.

An ambiguity arises, however, when the “fact patterns” exist and the “situation” occurs. Does one paragraph take precedence over the other? If so, which one? Or is there a third choice, blending the guidance of these two paragraphs?

The Committee believes that a blending of the guidance is most appropriate because it would avoid these misleading results:

- If paragraph 10 were to take precedence, then a significant reinsurance liability would suddenly disappear if the direct liability happened to slip below zero and then suddenly reappear when the direct liability returned to a positive number.
- If paragraph 11 were to take precedence, income would be impaired when the calculated direct liability declined to less than zero and as it continued to decline, even if the risk were reinsured. That impairment would eventually reverse, inflating income as the direct liability rises back toward the floor.

We believe that an appropriate blend could be achieved by the addition of the following sentence to the end of paragraph 11:

> “*FinREC believes that when such a fact pattern produces a reinsurance liability at the same time that the insurer calculates a direct liability less than zero, the insurer should adjust the reinsurance liability to offset the effect of flooring the reinsured portion of the direct contract liability.*”

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We would welcome the opportunity to speak with you in more detail and answer any questions you have regarding these comments. If you have any questions or would like to discuss further, please contact Shera Evans, the Academy’s risk management and financial reporting analyst, at niemirowski@actuary.org.

Sincerely,

Steven F. Malerich
Chairperson, Financial Reporting Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries