

Summary of Comment Letters
FASB Invitation to Comment, An FASB Agenda Proposal:
Accounting for Insurance Contracts by Insurers and Policyholders,
Including the IASB Discussion Paper,
Preliminary Views on Insurance Contracts

INTRODUCTION

1. This is a summary of the comment letters received in response to the FASB Invitation to Comment, *An FASB Agenda Proposal: Accounting for Insurance Contracts by Insurers and Policyholders, Including the IASB Discussion Paper, Preliminary Views on Insurance Contracts*.
2. The purpose of the Invitation to Comment was to gather information from FASB constituents to help the Board in deciding whether to add to its agenda a joint project with the IASB on insurance contracts. The objective of that project would be to develop a high quality global standard that would address recognition, measurement, presentation, and disclosure requirements for insurance contracts. It would replace all existing U.S. generally accepted accounting principles (GAAP) and international financial reporting standards (IFRS).
3. Although existing U.S. GAAP includes a substantial amount of guidance on accounting for insurance contracts, there is no comprehensive international accounting guidance. Issued in May 2004, IFRS 4, *Insurance Contracts*, generally permits previous accounting practices for insurance contracts to continue until an international standard is developed. The lack of uniform international accounting guidance for insurance contracts results in national accounting practices that are diverse and financial reporting that lacks comparability.
4. The IASB is actively working on a project to develop an international accounting standard for insurance contracts and in May 2007 issued a Discussion Paper, *Preliminary Views on Insurance Contracts* (Discussion Paper—sometimes referred to as the DP by respondents), setting forth its preliminary views on the

main components of an accounting model for an insurer's (or more broadly issuer's) rights and obligations (insurance assets and liabilities) under an insurance contract. That Discussion Paper is included in the FASB's Invitation to Comment. Comments on both the FASB's Invitation to Comment and the IASB's Discussion Paper were due on November 16, 2007.

5. The principal focus of the IASB's Discussion Paper is the measurement of insurance liabilities. The measurement attribute proposed is current exit value (CEV)—that is, the amount that the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another party. CEV is similar to the definition of fair value in FASB Statement No. 157, *Fair Value Measurements*, and, as proposed, would apply to the recognition and measurement of all insurance contracts—including life, health, and property-casualty insurance contracts (referred to as life and nonlife insurance contracts in the Discussion Paper).

PROFILE OF RESPONDENTS

6. Through January 31, 2008, 44 comment letters were received. Forty-two of those letters were in response to the FASB Invitation to Comment—two of the letters were simply copies of responses to the IASB’s Discussion Paper. A high-level overview of the IASB’s comment letters is available at its website (www.iasb.org) as Observer Notes for its February 2008 Board meeting. Accordingly, this summary is based on the 42 letters. The following table summarizes the number of letters submitted by each type of organization:

Type of Respondent	Number of letters
Preparer	
Insurance entities (including financial service entities with significant insurance operations)	12
Insurance industry associations	8
Noninsurance entity	1
Total Preparer	21
Public Accounting	
Accounting firms	4
Accounting associations	3
Total Public Accounting	7
Users	
Rating agencies	3
Analyst	1
Total Users	4
Actuarial associations	3
Consulting firms	2
Academic	1
Regulator (NAIC)	1
Standard Setter (Germany)	1
Individuals	2
Total	42

7. This summary follows the sequence of the questions asked in the Invitation to Comment.

SUMMARY OF RESPONSES

Question 1: Is there a need for the FASB to comprehensively address accounting for insurance contracts? Why or why not?

- a. What aspects of existing U.S. GAAP accounting for insurance contracts could be improved or simplified and how pervasive are these issues?**
- b. How important is the development of a common, high-quality standard used in both the U.S. and IFRS jurisdictions?**

8. Most of the comment letters recommended that the FASB participate with the IASB in a joint insurance contracts project to develop a comprehensive international accounting standard. Many respondents saw the need for a joint project because of the global nature of the industry and the current lack of international insurance accounting guidance. Some of the respondents supporting a joint project believe that U.S. GAAP is adequate and, at most, in need of only minor repair. However, they also believe that the convergence process dictates that a joint project with the IASB is necessary for the U.S. to have an impact in the development of a global insurance contracts accounting standard. Recent actions by the SEC concerning the use (foreign registrants) and potential use (U.S. registrants) of international accounting standards has heightened and accelerated the need for a joint project in the eyes of some respondents. Several respondents also noted that the FASB's involvement in a joint project would help highlight U.S. insurance products and industry concerns and perhaps result in some consideration of U.S. GAAP in developing measurement and recognition approaches for a global insurance contracts standard.

9. A supporter of a joint insurance contracts project, Standard & Poor's Ratings Services (S&P) (CL 27) made the following observations about the state of U.S. accounting for insurance contracts:

We support the Board undertaking a joint effort together with the International Accounting Standards Board (the IASB) to address insurance contract accounting. Insurance accounting has historically evolved with a focus on the insurance products being marketed by insurers, rather than developed as part of a comprehensive framework addressing the conceptual accounting issues related to these contracts. As a result, the current state is one where the accounting framework for insurance contracts is fragmented and produces results which often are not consistent among products or types of exposure, and may not be consistent with the underlying economics of the transactions. Further, the disclosures are also incomplete and inconsistent and do not provide our analysts with adequate information (e.g., regarding the nature and timing of the actual and potential underlying cash flows; significant assumptions used; the potential volatility of future cash flows and variations in assumptions).

10. A comment letter submitted by six insurance industry associations (CL 25) included a reference to the SEC actions:

As businesses become more global in nature, it is important that there exist a level playing field for all participants. Appropriate global standards for insurance accounting would enable analysts and investors to compare the financial statements of entities with similar products across the world.

...it is important to have global insurance accounting standards that account for similar insurance liabilities in a similar manner and that, for the purposes of convergence, the FASB should add the project to the agenda as a joint project as soon as possible given the possibility that the SEC may move to allow both foreign filers and U.S. filers to file audited financial statements using International Financial Reporting Standards.

11. The Travelers Companies, Inc (CL 26) echoed the need for a global accounting standard for insurance contracts to put all participants on a level playing field and provide investors the ability to compare two entities that issue similar products no matter where they are located. However, Travelers also emphasized the need for that standard to accommodate the substantial differences in world-wide insurance products and legal systems.

12. ACE Limited (CL 15) gave qualified support to a joint project and global accounting standard for insurance contracts—that is, the resulting global standard

must be a clear improvement over U.S. GAAP. ACE observed that “to develop a global accounting standard for insurance contracts that is an improvement to U.S. GAAP, the FASB must be fully engaged in its development and not solely rely on the IASB.” If not a clear improvement, ACE believes “it would be best to forego a global accounting standard for insurance contracts and maintain a separate accounting basis for U.S. GAAP.”

13. PricewaterhouseCoopers (PwC) (CL 31) also supports a global accounting standard for insurance contracts and FASB participation in a joint project while focusing on the international need for such a standard. PwC noted that “because of the global significance of the U.S. insurance industry, the FASB’s participation is important to the success of an ultimate global insurance standard.”

14. Deloitte & Touche (Deloitte) (CL 14) noted that it would not recommend the FASB undertake an insurance contracts project because the U.S. already has a set of insurance accounting standards that “are accepted and well understood by users, preparers, and auditors.” However, Deloitte said that it understands “the need for the IASB to develop guidance on accounting for insurance contracts, since international financial reporting standards (IFRSs) do not currently contain such guidance.” Deloitte also stated that it believes “that users of financial statements would significantly benefit from a common, high-quality standard that is applied internationally by participants in the insurance industry and that the FASB should work closely with the IASB in developing such a standard.”

15. The Deutsche Aktuarvereinigung e.V. (DAV) (CL 8), a German actuarial association, noted the need for a principles-based global accounting standard. The DAV observed that insurance is mainly the simple acceptance of uncertainty for a price, however the diversity of products and complexity of the business and insurance accounting require a high-quality, principles-based global accounting standard to achieve comparability of world-wide financial reporting.

16. The American Academy of Actuaries (AAA) (CL 20) commented on some of the costs of not having a global insurance accounting standard:

Many of the largest insurers in the world are international businesses. When it comes time to produce consolidated income statements for such entities, differing accounting standards cause additional expenses for those companies and increase the possibility of error in the statements. Furthermore, training of staff in multiple accounting systems is difficult and expensive. It would therefore be of considerable help to the industry to have a common standard between the US and IFRS jurisdictions (or to at least minimize the extent of any differences, perhaps to only those that are necessary due to jurisdictional differences in products and/or legal environments).

17. On the other hand, Northwestern Mutual Life Insurance Company (CL 7) cautioned about the costs of convergence:

Given the increasingly global nature of our industry and the capital markets, the development of common, high-quality standard used commonly in the U.S. and internationally is a worthwhile objective. However, we suggest that the potential benefits of convergence not create a mandate or urgency that underestimates the challenges and costs for preparers, users and auditors.

Need for Timely FASB Involvement

18. Several commentators emphasized that the FASB's timely participation in the IASB's insurance contracts project was important to ensure (a) that its U.S. constituency is adequately represented and (b) that U.S. GAAP receives proper consideration in the international deliberations. Some noted that later involvement by the FASB in the convergence process would make developing a common global standard more difficult.

19. American International Group (AIG) (CL 41) encouraged the FASB to add to its agenda a joint project noting that "attempting to achieve convergence by joining this process after the IASB begins its project would likely be difficult."

20. PwC (CL 31) raised concerns about the need for timely FASB involvement in a joint insurance contracts project to minimize differences between U.S. GAAP and an international standard, but added the caveat that the FASB not slow the project down:

Early FASB participation in the IASB project will be more effective than attempted convergence after the IASB has completed its work.... FASB participation in the IASB project will minimize the differences between IFRS and U.S. GAAP. Absent a joint project, U.S. GAAP financial statements will likely differ significantly from those prepared in accordance with future IFRS. Minimization of these differences will help investors by making it easier to compare U.S. issuers' financial results with the results of their foreign competitors.

Because of the pressing need for an IFRS on insurance accounting, we recommend that the FASB add this project on to its agenda only if it believes it can do so without significantly delaying the issuance of the much needed IFRS.

21. Taking a different view, Moody's Investors Service (CL 44) noted the importance of FASB participation in a joint project, and acknowledged that such participation could delay the project. They stated that "we consider convergence to be of much greater importance than meeting the projected 2011 implementation date."

No Insurance Contracts Project is Necessary

22. Most of those who did not support a joint insurance contracts project were generally satisfied with U.S. GAAP accounting for insurance entities—although a few suggested limited improvements to U.S. GAAP.

23. The National Association of Mutual Insurance Companies (NAMIC) (CL 23) questioned the need for a joint project and stated "...more important than imposition of a comprehensive accounting standard for insurance contracts—or at least the first exercise in a critical path for a project of this magnitude—is proving inadequacy of current practice. We suggest to the Board that no fatal weakness is

present nor any shortcoming that demands migration to what is visible in the IASB Discussion Paper.”

24. Professor Richard Macve, London School of Economics, (CL 4) stated that “there is no need for the FASB to add this proposed item to their agenda given the 'fair value' option now available to insurers in SFAS159 (FASB, 2007), *The Fair Value Option for Financial Assets and Financial Liabilities*...which will allow ‘realistic’ reporting and avoid accounting mismatch of assets and liabilities.”

25. Huron Consulting Group (CL 37) questioned “whether fair value is the relevant measure of insurance liabilities for all types of insurance and all users of financial statements; therefore, [it believes] the fair value option of SFAS 159 is adequate.”

26. The Association of Financial Guaranty Insurers (AFGI) (CL 29) expressed concern about the interrelationship of a joint insurance contracts project with other important joint projects and suggested that “...the FASB and the IASB (collectively "the boards") have added to their agendas [a number of fundamental projects], including the conceptual framework, revenue recognition and financial statement presentation.... We believe therefore that the boards should defer further consideration of the specific project on accounting for insurance contracts until it is clearer what the ultimate outcome will be for the more fundamental projects.”

Question 2: Are the preliminary views expressed in the IASB’s Discussion Paper a suitable starting point for a project to improve, simplify, and converge U.S. financial reporting for insurance contracts? If not, why not?

- a. **Do you believe the preliminary views would be feasible to implement? If not, what aspects of the preliminary views do you believe could be difficult to apply and why?**
- b. **Are there other alternatives to improve or simplify U.S. financial reporting for insurance contracts that you would recommend? What would be the benefits of those alternatives to users of financial statements?**

The IASB's Discussion Paper is an Appropriate Starting Point

27. Some of those who supported the IASB's Discussion Paper and the CEV model as a good starting point for the FASB's deliberations believe it is a principles-based approach applicable to all kinds of insurance products that would enhance comparability among various types of insurance entities and enable users to better understand the financial statements of those entities. However, most of the supporters expressed some concerns over the implementation of CEV.

28. Alan Zimmerman (CL 19) stated that "while I have some concerns with specific issues, I believe that taken as a whole the preliminary views on insurance accounting expressed in the IASB document are a significant improvement from current generally accepted accounting principles.... I also believe that given time users will find considerable merit in the likely proposed IASB standards although because many of these concepts are new and different this will take time and education."

29. Fitch Ratings (CL 33) agreed that the Discussion Paper is a suitable starting point for a joint insurance contracts project but suggested that "alternative valuation methods such as 'current entry value' and 'settlement value' should be considered."

30. Deloitte (CL 14) stated that "while we believe there is a need to explore certain related issues in more detail, we agree that a fair value concept under FASB Statement No. 157, *Fair Value Measurements*, or a current exit price view as described in the discussion paper, is the logical way to begin the discussion." Deloitte also noted that "while insurance contracts are often similar to other financial instruments, they differ significantly from most financial instruments in one aspect — transferability."

31. Ernst & Young (E&Y) (CL 43) supported the Discussion Paper as a starting point that "clearly identifies the issues that must be addressed to improve,

simplify, and converge accounting for insurance contracts. While we believe that the appropriate issues have been identified in the DP, we do not agree with some of the preliminary views taken by the IASB in the DP (e.g., current exit value) and believe that certain preliminary views would be difficult to apply (e.g., margins as defined in the DP)... The current exit value approach is fundamentally different from the approach currently applied by preparers and fundamentally different from the way in which we believe that users view financial statements.”

32. The National Association of Insurance Commissioners (the NAIC) is the association of U.S. state insurance regulators. The Statutory Accounting Principles Working Group (SAPWG) of the NAIC (CL 17) acknowledged industry concern over the CEV proposal and the associated building blocks (unbiased probability weighted estimates of cash flows, time value of money adjustments thereof, and a margin that would be demanded by market participants). However, SAPWG did not disagree with the approach in the Discussion Paper for general purpose financial statements because the proposal makes it clear that “the use of a measurement model using the three building blocks is not meant to imply that insurance liabilities can, will or should be transferred to another party.”

The IASB’s Discussion Paper is Not an Appropriate Starting Point

33. About half of the respondents—including substantially all of the preparers—believe that the Discussion Paper is not an appropriate starting point for the FASB’s deliberations. A few of those opposing CEV said they agreed conceptually or in principle with the IASB’s proposed model, but had serious concerns regarding its implementation.

34. Some of those opposed to the CEV proposal suggested that U.S. GAAP accounting for insurance contracts should be the starting point for the insurance contract deliberations—especially for property-casualty contracts. Several respondents noted that U.S. GAAP accounting guidance for property-casualty

insurance contracts is similar to the accounting for those contracts in many countries worldwide. They also said they believe it is well understood by users, is transparent and lacks the complexity of CEV. Some suggested that disclosures are all that is necessary to improve the U.S. GAAP property-casualty accounting model. For example, the Group of North American Insurance Enterprises (GNAIE) (CL 38) stated that it believes “the starting point for a reconsideration of insurance and reinsurance accounting and financial reporting should give greater consideration to elements of existing U.S. GAAP. This is especially true for non-life insurance contracts, where many financial statement users and preparers have voiced serious concerns with the measurement model proposed in the DP and have reiterated the belief that the existing measurement and reporting model used world-wide is ‘not broken’.”

35. Using existing U.S. GAAP accounting guidance for life insurance contracts as a starting point for the life insurance contract accounting deliberations has more limited support than using U.S. GAAP for the property-casualty guidance. Issues cited with U.S. GAAP for life insurance contracts center on its complexity—for example, its numerous product-based models (FASB Statements No. 60, *Accounting and Reporting by Insurance Enterprises*, No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, and No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises for Certain Long-Duration Participating Contracts*), its detailed rules (AICPA Statement of Position 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and Separate Accounts*, and AICPA Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts*), and its bifurcation requirements (Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*). However, some would propose developing

an improved (principles-based) version of the U.S. life insurance accounting model, while others would propose a modified CEV model.

36. A letter from six insurance industry associations (CL 25) provided a list of reasons why they believe the Discussion Paper is not a suitable starting point for the joint project. Some of those reasons are:

- a. It is based on the incorrect premise that all insurance contracts are economically similar to financial instruments.
- b. The measurement objective described in the current exit value model in the DP is irrelevant and may be misleading to investors since the transfer in most instances can not happen due to regulatory constraints. Additionally, the model requires the use of hypothetical assumptions that can not be verified, and gives priority to such hypothetical assumptions when more relevant and reliable entity-specific information is available that more accurately reflects the characteristics of particular portfolios of contracts.
- c. Some of the views expressed are inconsistent within the paper. For instance, the DP stresses a current exit value model but attempts to limit the inclusion of premiums and dividends in the liability calculation which market participants would include in an economic valuation.

37. The American Council of Life Insurers (ACLI) (CL 39) also listed its objections to the Discussion Paper. Some of those are:

- a. Guidance should be principles-based - The building blocks proposed in the DP for measuring insurance liabilities are too detailed in prescribing techniques in determining the value of the liability. We believe that the details should be provided by the actuarial profession...based on the principles-based guidance provided by standard setters.
- b. Gain and losses at issue - We are very concerned with the notion of recognizing accounting gains and losses at issue when observable market inputs do not exist in a manner that should override the pricing of the contract in a competitive market.
- c. Unbundling of insurance contracts - We are strongly supportive of the notion that insurance contracts are instruments that should not require unbundling. Contracts are priced as a single unit and are

typically transferred as a single unit.... The components are closely related both in policy structure and in the way they are priced.

- d. Use of exit value for measurement of liabilities - Within the industry, there are differing views about the [CEV] measurement. Given that insurance companies have a held-to-maturity intent with the insurance contracts they hold, it is unclear which method, or a combination, is a more appropriate measure. If a fair value measure is determined to be appropriate, we believe that special consideration will need to be given to the lack of active markets for insurance contracts and a possible modification will be required to permit some level of entity-specific inputs. We are also concerned about the incorporation of the insurer's own credit rating into the determination of insurance liabilities.
38. Hartford Financial Services Group (CL 16) suggested that the starting point for joint project discussions should be U.S. GAAP and said that "...without a complete conceptual framework and revenue recognition model, the proposed current exit value model appears to lack meaningful metrics that would enable management and other financial statement users to explain top line growth and bottom line results."
39. Northwestern Mutual (CL 7) concurred with Hartford on using U.S. GAAP as a starting point and asked that "the FASB challenge and validate the assertion that a 'mark-to-model' accounting framework, as advocated in the DP, better meets the needs and expectations of insurance financial statement users...versus one based on historical cost with appropriate fair value disclosures."
40. Veris Consulting, LLC (CL 18) supports the current insurance accounting model and notes that "the predominate users of GAAP financial statements are, arguably, investors. Typically, investors are more concerned with the ability to project future earnings than with the current valuation of existing assets and liabilities. In many respects, the U.S. GAAP insurance accounting model with its emphasis on matching revenues and expenses is better suited to measure earnings emergence and, thereby, facilitate projections of future earnings."

41. NAMIC (CL 23) also disagrees with a model based on financial instrument accounting, stating that “in imposing much of the essence of IAS 39 on the insurance business, i.e. regarding insurance contracts or insurance risk as akin to financial instruments and their markets, the preliminary views in the IASB's Discussion Paper disqualify it as a practical vehicle for a comprehensive insurance-accounting standard.”

42. In rejecting the Discussion Paper proposal, Huron Consulting (CL 37), like many others, suggested field tests “with a representative sample of small, medium and large insurers to understand whether the information needed to estimate contractual cash flows from a market participant's perspective is available or can be obtained at an appropriate cost.”

43. AIG (CL 41) objected to the Discussion Paper noting that the DP proposes “a model consistent with the IAS model for accounting for financial instruments. Given the lack of an observable market for the transfer of most, if not all, insurance liabilities, this model is largely conceptual...” AIG also noted that “the insurance company's obligation to stand ready to perform represents a performance obligation which is not typical in most financial instruments and makes the transfer of the contracts difficult. The model for financial instruments is therefore not appropriate for most types of insurance contracts.”

Which Aspects of the Discussion Paper Could Be Difficult to Apply?

44. Most respondents believe the CEV will be difficult to implement. For example, Moody's (CL 44) expressed the following concerns (among others) about implementing the Discussion Paper proposal:

- a. The addition of discounting and risk/service margins to the calculation of insurance liabilities will add further complexity to the calculation of estimates, and this could make it more difficult for investors to determine the sufficiency of the reserves.

- b. ...the CEV concept will ultimately rely on ‘mark-to-model’ methods, with all the credibility challenges typically associated with such approaches.
- c. Without guidance on which to base decisions about reasonable assumptions to use in determining the building blocks of CEV, the proposal gives practitioners latitude in selecting the range of assumptions to be used, thereby raising the risk of earnings manipulation and making financial analysis more difficult.
- d. We believe that detailed disclosures, including the expected timing of cash flows, discount rates utilized, and determinants of risk and service margins, would be necessary to make the financial statements useful to analysts.
- e. Profits recorded immediately upon the signing of a contract may not materialize.

45. Hartford (CL 16) stated that it does “not believe that the IASB's preliminary views would be feasible to implement. The introduction of discounting and the use of risk margins based on unobservable market assumptions into the measurement basis of insurance contracts will present valuation difficulties for preparers and will present a false sense of relevance and comparability to users. In addition, [Hartford believes] that the probability-weighting of all possible cash flows is impracticable and will not result in more reliable estimates of insurance liabilities.”

What Improvements Could Be Made to U.S. GAAP?

46. Several suggestions for the improvement or simplification of U.S. GAAP noted problems with piecemeal fixes or suggested minor tinkering. The following discussion of possible improvements to U.S. GAAP indicates that the property-casualty industry is reasonably satisfied with its current accounting guidance suggesting some additional disclosures focused mainly on the uncertainties associated with claims liabilities. However, the life insurance industry suggests simplifying much of their product-oriented accounting guidance and eliminating

certain “rules” related to guidance on accounting for nontraditional life insurance contracts, replacement deferred acquisition costs, and derivative accounting.

General

47. CIGNA Corporation (CL 6) saw no need to overhaul the current U.S. GAAP accounting models for insurance contracts:

In encouraging the FASB to participate in a joint project, CIGNA emphasizes that a major overhaul of the current insurance contract models used in the United States is not needed. In fact, we view SFAS Nos. 60, 97 and 113 as the most logical starting point for a principles-based standard to provide users with the most relevant, reliable, and current information and to converge with International standards.

The application of the appropriate accounting model then produces a liability measurement that is largely a settlement value - although for long duration contracts, the models do recognize the time value of money. CIGNA believes that these accounting models appropriately balance reporting for complex contracts at a reasonable cost, while providing decision-useful financial information to all users.

48. E&Y (CL 43) concluded that “any selective improvements to one aspect of the insurance accounting model is likely to require that other issues be addressed due to the complex nature of the insurance models. Therefore, we believe that anything short of a comprehensive study of accounting for insurance contracts would be counterproductive.”

49. PwC (CL 31) had the following observations concerning issues with U.S. GAAP but concluded that working on a joint project would be more beneficial than working on improving U.S. GAAP:

We do not perceive a great deal of concern from users about insurance company financial statements prepared under U.S. GAAP. Based on our discussions with analysts, we understand that the information currently included in insurance companies’ U.S. GAAP financial statements is generally considered adequate for their purposes (i.e., analyses and forecasting.) Inconsistencies that exist in the results of accounting for significant items (e.g., deferred acquisition cost amortization, accounting mismatches, risk transfer, and revenue

recognition) are adequately compensated for with additional disclosure. Hence, we believe participation in efforts to develop a worldwide standard is a better place to focus the FASB's efforts.

Definition of an Insurance Contract

50. Several respondents suggested basing a U.S. GAAP definition of an insurance contract (which currently is not defined in U.S. GAAP) on the IFRS 4 definition of an insurance contract. One significant feature of the IFRS 4 definition is that it applies to contracts written by noninsurance entities, a broader scope of contracts than commonly considered to be insurance in U.S. GAAP which technically applies only to contracts written by insurance companies. For example, the ACLI (CL 39) stated that “we believe the definition contained within IFRS No. 4, *Insurance Contracts*, is an appropriate definition to carry over into a new standard. We support a definition that incorporates all insurance contracts including those not written by insurance entities.

51. Travelers (CL 26) agreed stating that “we believe that the current definition in IFRS is an improvement over U.S. GAAP and should be considered.... The insurance guidance should be more principles based with a focus on the type of contract written rather than the writer of the contract.”

52. S&P (CL 27) stated:

...the lack of a comprehensive framework has resulted in non-insurance entities becoming parties to arrangements with economically similar attributes and cash flows to insurance contracts, but accounting for these arrangements in meaningfully different ways.

53. On the other hand, UnitedHealth Group (CL 24) noted that the Invitation to Comment lists a few examples (including letters of credit and warranties) of contracts that could meet the IFRS 4, *Insurance Contracts*, definition of insurance that it believes “are captured in other standards that provide better measurement and reporting than would exist if they are scoped into this standard.”

Property and Casualty Insurance (Nonlife)

54. Only a few respondents commented on improving property-casualty accounting guidance. They focused principally on claims liabilities.

55. Alan Zimmerman (CL 19) made the following observations about short-duration claims liabilities:

I have long believed that expressing a liability as the "best" single point estimate, as required under FAS 5, is an outdated concept that no longer reflects how reporting entities make decisions.

Recording short duration reserves at nominal value does not represent the value of the obligation. Allowing short duration liabilities to be recorded with cost-based attributes creates an inconsistency with assets recorded at fair value.

56. However, Veris Consulting (CL 18) noted that discounting of property and casualty loss reserves "has been actively debated for many years, but opinions and current practice continue to vary."

57. ACE (CL 15) commented on the use of probability-weighted averages for measuring short-duration claims liabilities:

For property/casualty or short-duration insurance contracts, the current "single best estimate" to measure claims liabilities may not be the most appropriate approach when there are numerous potential loss scenarios as of any balance sheet date. In this regard, we believe the use of probability-weighted averages to measure claim liabilities should be explored by the FASB.

Life Insurance

58. Respondents commenting on improvements to U.S. life insurance accounting focused mainly on simplifying the multiple accounting models, rules-based guidance, and bifurcation of derivatives. Two respondents also commented on the Statement 60 "lock-in" concept for traditional life insurance contracts where the assumptions underlying the measurement of life insurance policyholder benefit liabilities remain unchanged until a premium deficiency test is failed (a

liability adequacy test in IFRS 4) at which time a loss is recognized and the assumptions are reset.

Simplification

59. The American Academy of Actuaries (AAA) (CL 20) noted the current patchwork of accounting guidance for long-duration insurance contracts:

...current GAAP accounting for life and similar health insurance coverages largely reflects a patchwork of guidance that requires close attention to detailed instructions rather than focus on getting the proper measurement. We believe the time has come for developing a standard structure that will avoid the considerable complexity that currently exists.

60. Hartford (CL 16) elaborated on bifurcation requirements:

In lieu of bifurcation, all obligations to the policyholder should be accounted for together as one arrangement since the product features are integrated.

With regard to the issue of bifurcation of embedded derivatives under FAS 133, the current guidance allows for the inconsistent treatment of certain insurance products, specifically annuity products, which have similar product features. We believe that the elimination of this inconsistency will result in a more relevant presentation of these products and will no doubt simplify the accounting and financial reporting for these contracts.

61. Northwestern Mutual (CL 7) commented further on some of the long-duration contract complexity:

The current accounting framework for deferred acquisition costs, especially retrospective adjustments and internal replacement requirements, is burdensome, unnecessarily complex and creates confusion for users of insurer financial statements.

Long-Duration Contract Liabilities

62. Alan Zimmerman (CL 19) made the following observations about long-duration liabilities for policyholder benefits:

Locking in the assumptions on long duration liabilities do [sic] not allow financial statement users to understand current conditions.

Adding a margin for adverse deviation to long duration contracts distorts the true value of the liability.

63. ACE (CL 15) observed that “for life or long-duration insurance contracts, significant changes in loss exposure can have no effect on income because of the lock-in of reserving assumptions. This aspect of FAS 60 can be improved.”

Reinsurance and Risk Transfer—Statement 113

64. Most of the comments concerning reinsurance and Statement 113 focus on improving the risk transfer guidance. Several respondents noted that these issues are being addressed in FASB’s risk transfer project which should satisfactorily address the subject.

65. The Accounting Principles Committee of the Illinois CPA Society (ICPAS) (CL 1) suggested a replacement for Statement 113: “an objectives-based standard that is more consistent with the accounting for other financial instruments that transfer risk could improve transparency to users and regulators.”

66. With respect to risk transfer, Aetna Inc. (CL 32) stated that “these [recent] restatements emphasize the need for additional accounting guidance to assist preparers in determining whether a contract transfers sufficient risk to the insurer to qualify for insurance accounting.... [Aetna believes] the FASB is appropriately addressing the need for additional guidance with the current projects on its agenda: Insurance Risk Transfer and Financial Guarantee Insurance.

67. Endurance Specialty Holdings Ltd. (CL 36) requested limited additional risk transfer guidance, again referring to the FASB insurance projects:

Two areas we believe would benefit from additional guidance, but not a comprehensive rework of the existing guidance are (1) further clarification of the risk transfer requirements included in SFAS No. 113 and (2) clarification of how these risk transfer requirements apply to insurance contracts. It is our understanding that both of these issues are currently under review by the FASB.

Disclosure

68. Several respondents mentioned that enhanced disclosures is one way that U.S. GAAP could be improved. Often mentioned was the need for additional information about property-casualty claims liabilities. For example, Hartford (CL 16) suggested additional disclosures about the subjectivity and uncertainty of accounting estimates:

...we believe that U.S. GAAP could be improved with enhanced disclosures concerning the subjectivity and inherent uncertainty underlying critical accounting estimates, including but not limited to property-casualty loss reserve estimates.

We also believe that enhanced disclosures regarding critical accounting estimates would benefit users of financial statements by improving the quality and transparency of significant accounting policy disclosures. Enhancing users' understanding of critical accounting estimates, the impact those estimates have on insurers' financial statements and the sensitivity of such estimates should increase investor confidence in the financial reporting of insurers.

69. Fitch (CL 33) noted their US analysts' use of regulatory reporting to supplement the U.S. GAAP reporting:

Fitch's insurance analysts in the United States do not see the same urgency for reforming insurance accounting as their European colleagues, primarily because there are consistent standards among US insurers (at least within the same parts of the industry), our analysts are familiar with these standards and US analysts also make use of extensive regulatory reporting, which is publicly available.

70. Travelers (CL 26) also confirmed the use of statutory information by analysts who indicated that they use certain statutory loss and loss expense disclosures rather than current U.S. GAAP because the information is a better indicator of future performance.

71. Huron Consulting (CL 37) also focused on the need for more information regarding short-duration claim liabilities and said "...we believe that insurers should be required to disclose their estimated range of reserves, and the reasons

for changes to recorded reserves within the range. Disclosures could be added relating to the development of reserves over time against ultimate payout on the contracts. These would add to the financial statement users' ability to understand movements in reserves and make manipulation more difficult.”

72. CIGNA Corporation (CL 6) recommended additional information about future cash flows for insurance liabilities:

Although the current reporting model includes disclosure of the contractual cash flows for invested assets, the estimated cash flows of insurance liabilities is only required by the SEC for public companies. CIGNA believes that such a disclosure for all insurance companies would be useful information to allow users to assess any apparent mismatches of asset and liability cash flows.

Specialized Insurance Entity Accounting

73. Some commentators suggested improvements in accounting guidance for entities writing specialized insurance products.

Health Insurance Entities

74. AAA (CL 20) noted that the U.S. health insurance has evolved since the issuance of Statement 60 some 25 years ago. The AAA suggested that “it may be helpful at this juncture to develop a single set of GAAP accounting guidance that clearly pertains to all health insurance contracts without regard to the legal structure of the entity writing the contract.”

75. CIGNA (CL 6) believes that “...the FASB can help bring to the policy-setting discussion an understanding of the private medical insurance business in the United States, as this unique business model differs significantly from other insurance businesses currently represented in the international marketplace.

76. UnitedHealth (CL 24) added that “it has become increasingly difficult for financial accounting and reporting practitioners to wrap the technical literature around the new face of insurance contracts and products.”

Mortgage Guarantee Insurance Entities

77. Major areas of accounting for mortgage guaranty insurance (principally revenue and claim recognition) are excluded from Statement 60 and the Mortgage Insurance Companies of America (MICA) (CL 30) noted that “while new guidance is not necessary, the formalization of the current acceptable methods would provide clarity.”

Captive Insurance Entities

78. The Captive Insurance Companies Association and the Vermont Captive Insurance Association (CICA/VCIA) (CL 9) requested that special consideration be given to U.S. GAAP accounting guidance for captive insurance entities. The Federal Liability Risk Retention Act of 1986 (LRRRA) and captive legislation in multiple states allow captives and Risk Retention Groups to file GAAP financial statements with regulators in an effort to reduce the financial burden of reporting under GAAP and SAP. The differences between current GAAP and statutory accounting practices (SAP) are relatively minor compared to the accounting methods proposed in the IASB’s Discussion Paper. CICA and VCIA are concerned that the cost of reporting under multiple accounting bases combined with the cost of implementing new standards under a new accounting model could leave the alternative risk markets unable to respond to market needs.

79. Verizon Communications (CL 34) wholly owns an immaterial captive insurance company and suggests exempting captive insurance companies from any guidance emerging from the insurance contracts project. Verizon stated that “the proposal would require significant effort and expense with no benefit to the consolidated financial statements or their users. In our opinion it clearly violates the principal that the benefit of a FASB proposal should exceed its cost to implement.”

Question 3: Is there a need to address accounting by policyholders in an insurance contracts project? Why? If yes, should accounting by policyholders be addressed at the same time as the accounting by insurers? Can or should that wait until after the accounting by insurers is completed?

80. Most respondents considered policyholder accounting to be important, but many of those believed it could or should have a lower priority than the insurer's accounting for insurance contracts and could be deferred until the accounting by insurers for contracts is complete. A few noted that it should be done at the same time as the insurance contracts project—especially those who believe that the purchase of insurance by a policyholder is similar to the purchase of reinsurance by an insurer. Some believe that there should be symmetry in the accounting between the policyholder and insurer. Others see no connection or link between the accounting for the policyholder and the insurer. Some simply see no policyholder accounting issues and believe the current guidance is sufficient. Still others view policyholder accounting as generally immaterial.

Policyholder Accounting Needs to Be Done at the Same Time

81. E&Y (CL 43) believes that policyholder accounting should be addressed with the insurer's accounting:

Since potentially significant changes are being proposed to the accounting for insurance contracts by insurance companies, we believe there also could be a significant effect to the manner in which policyholders will account for the contracts they have purchased if policyholders have to follow the same or similar cash flow and measurement concepts. ...exposing and implementing a new accounting standard for insurance companies that does not allow for simultaneous exposure and comment on policyholder accounting could lead to significant issues raised by the commercial community.

82. Deloitte (CL 14) also believes that policyholder accounting should be addressed concurrently with the insurer accounting due to the lack of current guidance on accounting for certain aspects of insurance policies including transfer of risk and recognition of claims liabilities. Deloitte acknowledged that the

FASB's risk transfer project should provide some interim policyholder accounting guidance.

Needs to Be Done But Can Be Done Later, If Necessary

83. KPMG (CL 13) acknowledges that policyholder accounting is already being addressed by the FASB in its risk transfer project. However, it suggests that since the underlying concepts are similar to the accounting for the purchase of reinsurance by insurers, there is value to considering insurer and policyholder accounting at the same time provided they do not cause undue delay in developing the insurance contract accounting model.

84. International Actuarial Association (IAA) (CL 12) believes that accounting for ceded reinsurance should be addressed in the insurance contracts project, but believes that policyholder accounting can be deferred—perhaps until an Exposure Draft for insurance contracts has been issued.

85. MICA (CL 30) recommended that “the project include accounting by policyholder only in the context of ceded reinsurance. Any discussion of insurance contracts should include reinsurance and the concept of risk transfer.”

86. While Alan Zimmerman (CL 19) favors symmetry between policyholder and insurer accounting as a useful goal, he suggests leaving policyholder accounting to a later date.

87. S&P (CL 27) also generally expects symmetrical accounting between policyholders and insurers whether the insurance contract is written as a reinsurance contract or not. However, S&P would defer policyholder accounting if it would significantly delay the insurance contract project.

88. ACE (CL 15) would undertake policyholder accounting after completing the insurance contracts project and would expand the scope to include other accounting issues faced by commercial insurers such as the “valuation of claim liabilities for self-insured claim exposures, including those self-insured liabilities

arising from policy deductibles, held by captive insurers, and held by non-insurance entities.”

89. Northwestern Mutual (CL 7) does not see a necessary relationship between accounting by insurers and accounting by policyholders and sees limited synergy in addressing them together. Therefore, policyholder accounting can be deferred until after the standards for accounting by insurers are complete.

No Need to Address Policyholder Accounting

90. Some respondents believe that current policyholder accounting guidance is adequate and does not need to be improved. These respondents generally refer to the guidance in FASB Statement No. 5, *Accounting for Contingencies*. These respondents either see no issues with policyholder accounting or generally do not see a link between policyholder and insurer accounting.

91. Verizon (CL 34) believes Statement 5 provides adequate guidance for policyholders. Similarly ICPAS (CL 1) commented that reexamining Statement 5 would address the most important needs of policyholders.

92. The AICPA’s Accounting Standards Executive Committee and Insurance Expert Panel (AICPA) (CL 40) recommends “that policyholder accounting be addressed in a separate project, perhaps combined with a project on indemnities and guarantees.”

93. The comment letter from the six insurance trade associations (CL 25) saw no significant issues with policyholder accounting and, therefore, noted that policyholder accounting should have a lower priority. Additionally, they believe that “the accounting used by policyholders, particularly commercial enterprises, should be evaluated in the context of the policyholders’ accounting, not the insurers’ accounting.”

Question 4: How would you address the interaction between the accounting for insurance contracts and the FASB’s other projects on the conceptual framework, revenue recognition, liabilities and equity, financial instruments, and financial statement presentation? Are certain projects precedential?

94. Most of the respondents expressed concern over the interrelationship between the insurance contracts project and other joint projects (the interrelated projects listed above in Question 4) on the FASB’s agenda. The projects most often mentioned as significant in this respect were revenue recognition and financial statement presentation. Other projects frequently mentioned include the conceptual framework, liabilities and equity, and financial instruments. A few would complete these interrelated projects before starting the insurance contracts project. A few others would move forward on the insurance contracts project irrespective of the progress on the interrelated projects. Most would prefer parallel or tandem progress in the insurance contracts and the interrelated projects. Respondents had different thresholds of concern regarding the parallel progress of the projects. A few would consider certain projects precedential—for example, revenue recognition and financial statement presentation. Those respondents would prefer a high level of assurance that the outcomes of the precedential projects were known before the insurance contracts project was finalized. One concern noted by respondents was the potential impact on insurers if any of the interrelated projects ultimately resulted in conclusions different from those reached in the insurance contracts project and the possibility of having two major accounting changes in a relatively short period of time.

Insurance Contracts Project Must Move Ahead With or Without Interrelated Projects

95. Although their preference would be to have the interrelated general projects make progress along with the insurance contracts project, some believe the insurance contracts project should move ahead even without progress on the

interrelated projects because of the urgent need for international guidance on accounting for insurance contracts.

96. S&P (CL 27) would give priority to a global insurance contracts project but would prefer it be done concurrently with other projects that have clear implications for insurance accounting:

We recognize the Board is currently working on several projects that will clearly have implications for the insurance contract accounting project (e.g., conceptual framework, revenue recognition and financial statement presentation). However, a global financial reporting standard for insurance contracts is long overdue, and if necessary, should be given priority to jointly address insurance contract accounting with the IASB. Ideally, this will be done concurrently with other projects or in recognition of their likely direction.

97. Fitch (CL 33) believes that the conceptual framework and revenue recognition projects should be precedential to the insurance contracts project, but acknowledges the timing challenges and suggests that a post issuance review of insurance accounting be made to resolve any inconsistencies that emerge as the rest of the accounting develops:

98. Alan Zimmerman (CL 19) acknowledged the interrelationships between several important projects but also notes the need to move forward on the insurance contracts project. However, he also commented that “with this in mind, though, I believe, if feasible, that the income statement portion of the insurance contracts project should be consistent with the eventual development of reporting practices in the financial statement presentation project.”

99. The DAV (CL 8) observed that insurance contracts can be used to develop accounting approaches in related projects:

Insurance contracts are extreme [sic] complex contracts, in addition considering their extreme variety all over the world, which might include a variety of features affected by any of the [interrelated] projects referred to. Insurance contracts cause most complex recognition, derecognition,

measurement and presentation issues. However, we do not recommend awaiting the solution of all the issues mentioned, since those issues will need a permanent reconsideration and their development will never be finished. Insurance contracts are ideal items to develop approaches under extreme conditions. If concepts for assets, liabilities and performance are suitable in general for insurance contracts, it can be assumed that they work everywhere. We therefore recommend to develop insurance accounting closely with the developments in those projects but to look for reasonable and pragmatic solutions to achieve in even those extreme products suitable results and to use that knowledge gained here to fine-tune the general projects.

Insurance Projects Can Inform Interrelated Projects

100. Some noted that consideration of insurance accounting issues could help the Boards in their deliberations on the interrelated projects—perhaps as a stress test (insurance accounting examples often appear as test cases and examples in other projects). Some also noted that they believe it is important that the Boards be informed about insurance accounting issues as they deliberate the interrelated projects so the conclusions of those projects would be less likely to lead to subsequent changes in any newly adopted insurance accounting guidance or create the need for exceptions relating to insurance contract accounting.

101. ACE (CL 15) commented on the unique characteristics of insurance contracts and focused on the need to deliberate insurance contracts prior to the completion of the conceptual framework, revenue recognition, and financial statement presentation models to avoid potential exceptions related to insurance contracts.

Interrelated Projects Can Move in Tandem

102. Many commentators suggested that an insurance contracts project and the general projects proceed in parallel. Some deemed certain projects to be critical, but also realized they might not be completed together. At a minimum, close coordination and communication among the projects were recommended.

103. The AICPA (CL 40) noted that all the interrelated projects have significant implications for the insurance contracts accounting project:

...all these projects have significant implications on the accounting for insurance contracts. The definition of an asset affects the accounting for beneficial policyholder behavior. Revenue recognition issues are important as well. In US GAAP, for example, life insurance contracts have different definitions of revenue and different methods for its recognition over time depending of whether the contract is within the scope of FASB Statement No. 60, No. 97 or No. 113. A clear articulation of what revenue represents will be needed to converge these standards. The liabilities and equities project has implications on insurance contracts that contain an element of company discretion in the related benefits (interest crediting, cost of insurance charges, dividends, etc.). With respect to financial statement presentation, whether all insurance contracts are more appropriately represented as financial instruments and whether liabilities such as debt and contingent liabilities should reflect a current market approach are relevant debates for other industries besides the insurance industry.

104. Travelers (CL 26) believes the interrelated projects must move in tandem:

We believe that due to the distinct characteristics of insurance contracts, it is important for the [interrelated] projects...to be deliberated in tandem with the insurance contracts project. We are concerned that if the Board finalized other guidance prior to fully deliberating insurance contracts, it would set a precedent for the accounting for insurance contracts that would not be reflective of the characteristics of insurance contracts

105. KPMG (CL 13) believes that it is important that guidance for performance reporting and revenue recognition be developed by the Board:

We...believe that premiums earned by an insurer should reflect the consideration received for the service and should be reported as revenue. As a consequence, we believe that it is critical that guidance for performance reporting and revenue recognition also be developed by the Board. These other projects should consider the reporting of changes in insurance liabilities and assets and how and when measured margins should be released to income.

106. Deloitte (CL 14) commented that insurance accounting is essentially a subset of the revenue recognition and financial instrument projects and that significant progress should be made on those projects first:

Ideally, the FASB should first make significant progress on its other projects, especially the revenue recognition and financial instrument projects. Insurance accounting is essentially a subset of these two larger projects; therefore, decisions made in these projects will significantly affect the accounting for insurance contracts.

107. PwC (CL 31) believes that completion of the revenue recognition project is especially crucial to the insurance contracts project:

The Board should ensure, as much as possible, that the approach it ultimately takes in an insurance standard is consistent with the direction proposed for these related projects or, if that is not possible, that any differences reflect the unique characteristics of insurance contracts.... We believe the completion of the revenue recognition project is especially crucial.

108. E&Y (CL 43) believes that it is essential that the main conceptual issues raised by the Discussion Paper be subjected to wider discussion, in particular the measurement phase of the conceptual framework, the liabilities project, and the revenue recognition project. E&Y stated that “if the bases for the principal proposals in the DP were applied by analogy to the activities other than insurance, they would fundamentally change the financial reporting practices of all entities that prepare financial statements under both IFRS and U.S. GAAP.”

109. AIG (CL 41) noted the importance of close coordination with the interrelated projects—especially revenue recognition and financial statement presentation—which could significantly impact the determination of what is being measured and the relevant measurement attribute for insurance contracts.

110. Hartford (CL 16) believes that the elements of insurance contracts (especially property-casualty contracts) are much different than investment contracts and other more traditional financial instruments and encourages

simultaneous progress on the insurance contracts and financial instruments projects and sensitivity to the differences between insurance contracts and other financial instruments.

Complete or Make Substantial Progress on the Interrelated Projects First

111. A few respondents suggested that some or all of the interrelated projects should be completed (or at least substantially completed) before the insurance contracts project resumes—the assumption being that it will be difficult to make decisions concerning insurance accounting without an established fundamental accounting framework. For example, the Florida Institute of CPAs (CL 3) commented that “the Committee believes that the overall conceptual framework, revenue recognition and liabilities and equity should be the FASB's highest priorities and that accounting for insurance contracts should be considered along with other financial instruments.”

112. UnitedHealth (CL 24) believes that “it is important to have a framework and guiding principles in place before making significant changes in long-standing industry practices.”

113. Northwestern Mutual (CL 7) would complete interrelated projects, such as the conceptual framework and financial statement presentation projects, prior to initiating a project regarding the narrower issue of accounting for insurance contracts.