



committee on corporate reporting

August 24, 2006

Suzanne Q. Bielstein Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116

Re: File Reference No. 1325-100

Dear Ms. Bielstein:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") wishes to share its views on the *Invitation to Comment – Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting* (the "ITC"). FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is the senior technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily those of FEI or its members individually.

We appreciate the Financial Accounting Standards Board's (the "FASB") approach to undertaking this project. We are grateful to have the opportunity to provide the FASB with feedback and preliminary observations prior to the finalization of this ITC, as we expect undertaking a project on insurance and reinsurance accounting from both an insurer and policyholder perspective has multiple complexities that must be considered.

The ITC requested our views and comments on eleven issues included in Appendix A of the ITC. Our responses to each issue are attached to this comment letter as Attachment A. Our overall observation is that we object to the concept of bifurcating an insurance contract into insurance and deposit components. For reasons outlined in our response to the issues in Attachment A, we are concerned that bifurcating insurance contracts will result in less understandable, decision-useful information for our financial statement users.

We believe the current model for insurance accounting is well established, and is not fundamentally flawed. While we acknowledge a number of companies have had difficulties accounting for insurance or reinsurance contracts that transfer limited insurance risk, we do not believe these cases warrant wholesale changes to the accounting model used for insurance and reinsurance. Recently reported misstatements may be the result of misinterpretation or misapplication of current guidance, and therefore material changes to accounting for insurance are not necessary.

We believe most financial statement preparers understand and can apply either model of accounting: insurance or deposit. However, we are concerned that the requirements to bifurcate a contract at inception and to support subsequent accounting for the bifurcated contracts will introduce significant complexity, particularly for policyholders that may not have those skills resident in their staff. This complexity would also be apparent to financial statement users, as they attempt to understand the assumptions used to bifurcate a contract and the impact of that on a company's cash flows. Furthermore, the financial statements of insurers would also change significantly, as overall premiums and benefit costs would presumably be lower, resulting in less transparency to users of those financial statements. Due to the significant assumptions required to apply bifurcation, we are concerned that comparability will be greatly diminished and key metrics used in the insurance industry, such as benefit cost ratios, will be subject to increased volatility.

Furthermore, we object to the distinction made in the ITC between individual and group insurance contracts. Specifically, we believe the view that group contracts (i.e., contracts with one policyholder and multiple insureds, such as group term life or health insurance) should not be identified as insurance contracts that do not "unequivocally transfer significant insurance risk," thus would be subject to bifurcation. It is inappropriate to distinguish between individual contracts and group contracts, as both forms of insurance can transfer unlimited risk to the insurance carriers. The ITC also introduces the term "dollar-trading" when referring to an example of a group health insurance contract. Many of our insurance company members are not familiar with this term and further believe this is not an appropriate characterization of such contracts.

Additionally, we believe that this ITC detracts from the FASB's current convergence project with the International Accounting Standards Board (the "IASB"). Based on our understanding, the original intent of the FASB/IASB Joint Insurance Project (the "Insurance Project") was to allow the IASB to lead the project until a standard was developed, at which point the FASB would review the proposed standard to determine whether it would be acceptable as a replacement of the current insurance accounting model under U.S. generally accepted accounting principles. We believe this plan should be adhered to and that no significant proposals to change the insurance accounting model should be made until the completion of Phase II of the Insurance Project. We believe if the FASB is to address insurance accounting at this time it would be more appropriate to concentrate developing a framework that assists in defining or identifying risk transfer under FAS 113 due to recent abuses of insurance accounting rather than a complete overhaul of the insurance accounting model.

The ITC identifies three methods for bifurcating insurance contracts, but does not provide illustrative examples of these methods. Certain of our members attempted to model these

bifurcation methods to better understand the concepts proposed in the ITC. Although these models are very rough, they illustrate the complexity in "day one" and subsequent accounting, for both the insurer and policyholder, and highlight some of the concerns raised in this letter and attachment. We would be pleased to work with the staff of the FASB to share these models and provide guidance as to real-time application of any proposed accounting model.

Given the wide-ranging implications of a project like this, we fully support the FASB's deliberate and extended diligence process. To ensure all views are considered, we believe it is imperative to utilize a working group comprised of insurance providers and policyholders in addition to regular working group participants (i.e. audit firms, users, SEC, AcSEC, PCAOB, etc.) to perform detailed, in-depth field studies both before and after any potential exposure draft. This working group would fully engage constituents that will be impacted by such a project. To that end, CCR, as well as many of its members, would be happy to work with the FASB through this extensive deliberation process.

We appreciate the opportunity to express our views on this matter. Members of CCR will be pleased to meet with the FASB and Staff at its earliest convenience to discuss these issues in more depth and to clarify any comments contained herein.

Sincerely,

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Chair, Committee on Corporate Reporting

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3

Attachment A: THE ISSUES

Issue 1: Does the IFRS 4 definition of insurance contract identify insurance contracts and sufficiently distinguish those contracts from other financial contracts? Does the GAAP definition of insurance risk identify and separate that risk from other risks such as financial risk? Do the descriptions of finite insurance and reinsurance contracts, including the risk-limiting features, identify those contracts? How could the definitions and descriptions be improved? (page 10)

The proposed definition of insurance contracts appropriately captures the notion that the insurer accepts significant risk from the policyholder under a contract. However, references to how the insurer compensates or indemnifies the policyholder are too limiting. For example, in many forms of insurance, the insurer makes a payment to a provider (such as an automobile body mechanic for an automobile insurance claim or a hospital for a medical insurance claim); hence the insurer may not directly compensate the policyholder. The definition of insurance contract should acknowledge that certain contracts do not "compensate" the policyholder directly. Also, the term "compensation" is not consistent with the business objectives of some insurers which may pay claims that are preventative in nature. "Indemnify" would be a more appropriate term as it means "to prevent against damage." This term would allow the definition of an insurance contract to acknowledge that an insurance company may make payments for preventive health maintenance in order to mitigate more serious problems in the future.

In addition, the use of the term 'event' in the proposed definition of insurance contracts raises some questions. Does an event refer only to an occurrence, or can an event include an unknown development on a known occurrence, or the presentation of a claim? An 'uncertain future event' definition does not allow for an unknown or uncertain past event. This definition would preclude replacement coverage as an insurance contract. For example, pollution or product liability insurance for the discovery of an event which happened in the past, or an unexpected development on a known past event.

Finally, the definition of an insurance contract should acknowledge that the policyholder may be either an individual or an organization that groups individuals, such as an employer that sponsors insurance benefits for its employees. As discussed below, we do not agree that an insurance product purchased by a corporate policyholder that covers multiple insureds substantially differs from a contract between the insurer and a single individual; rather the contract with the corporate policyholder provides a means for the insurance company to offer insurance protection to a group of individuals, permitting an efficient mechanism to pool the transferred insurance risk.

We believe the ITC has inappropriately concluded that scenarios (b) and (c) in paragraph 19 are similar. In scenario (b) of paragraph 19, the employer offers its employees health protection, limiting its risk at the "expected level of payment", opting to buy insurance for claims exceeding this amount. In this scenario, the employer has accepted the risk of offering such a benefit to the employee. In contrast, under scenario (c) of paragraph 19, the employer has offered access to a health insurance contract at a group rate. In this case, the employer has not offered health benefits to the employee, rather it has offered access to health insurance. This is an important distinction that must be considered, as in one case, the employer is

obligated to provide health benefits (scenario (b)) and in the other case, the insurer is obligated to provide health insurance. Under the Employee Retirement Income Security Act of 1974 ("ERISA"), the plan sponsor is obligated to the member versus the administrative services provider, where as under an insurance contract (with no risk limiting features), the insurance company bears that obligation. Accordingly, the definition of an insurance contract should acknowledge that the policyholder is the insured individual (although that insured individual may have access to the insurance contract and have the cost of such insurance contract subsidized by a group, or corporate policyholder).

The GAAP definition of insurance risk (as defined in paragraph 35) does separate insurance risk from other risks, such as financial risks. This definition, unlike the definition of an insurance contract, appears to include unknown or uncertain past events, which would imply that replacement coverage or coverage of development on a known claim could be considered insurance risk. This definition also appears to include reinsurance contracts. Specifically, this definition demonstrates that the insured should not profit from the contract and that insured events are out of the control of the insured. We also believe that actual or imputed investment returns are an element of insurance risk, particularly in long duration contracts.

We do not believe defining the term finite risk insurance is required in support of this project, as finite insurance is a type of reinsurance contract and its definition can be implied through the definition of reinsurance. As such, we believe there should be only one definition of reinsurance. A separate definition of finite risk allows some contracts to fall between the criteria of the two contracts therefore increasing the complexity of accounting for these contracts.

Issue 2: Can the Statement 113 risk transfer guidance for reinsurance contracts be applied by corporate policyholders and insurers for determining whether an insurance contract transfers significant insurance risk? If not, how can the Statement 113 guidance be modified or clarified to apply to insurance contracts? (page 11)

Based on the description in paragraphs 39 and 40 of the ITC, the 10/10 rule for determining if significant insurance risk is transferred for reinsurance contracts would seem to be a reasonable approach for determining the substance of a contract. Although establishing a "bright-line" measure can sometimes lead to practices which are not within the spirit of a standard (for example the 90% threshold for determining whether a lease is a capital lease), the 10/10 rule may be a better method for determining the transfer of risk in both insurance and reinsurance arrangements than any of the proposed bifurcation methods due to its simplicity, acceptance and ease of application. To avoid potential abuses associated with a bright line threshold, we also believe the principles in FAS 113 should permit management to take a subjective approach to determine the threshold for significant risk transfer.

Issue 3: Does classifying an entire contract as insurance or bifurcating that contract into insurance and deposit components provide more understandable and decision-useful information? Which qualitative characteristics most influence your decision? Which approach more faithfully represents the economic substance of the contract? Why? (page 14)

Accounting for an insurance contract as either insurance or a deposit contract, without bifurcation more faithfully represents the economic substance of the contract. The contract is entered into as an entire agreement. Because the agreement is taken as a whole, the accounting should correspondingly be handled as one transaction and not bifurcated. We believe that both relevance and reliability would be compromised if insurance contracts are bifurcated for financial reporting. The bifurcation would complicate the financial statements, significantly impacting a users' ability to predict future cash flows. Comparability would not be enhanced as each company would inherently use different assumptions when determining the appropriate degree of bifurcation, not to mention the difficulties we anticipate with "day two" accounting. We do not believe that understandability and decision usefulness will be improved with bifurcation of insurance contracts as bifurcation would cause the financial statements to become more complex. Based on models some CCR members have attempted to create, it is apparent that net income for the insurer and the policyholder would likely not change (i.e., presumably the concept of matching incurred claims to the policy period would still exist; hence reported net income should not change); however the income statement and balance sheet presentation of these contracts would be vastly different.

There may be some merits to the theory of bifurcating a contract between its insurance and deposit elements, however, based on our modeling and assessment; we do not believe the concept of bifurcation can be applied consistently or reliably. Ultimately, bifurcation would yield financial results for an insurance company that are less transparent and key performance metrics used will be subject to a much higher degree of volatility, but would have little to no impact on net income reported. We are concerned that the information used to bifurcate a contract and subsequent "day two" accounting cannot be applied consistently internally as well as competitively, which would result in a lack of comparability from both period to period as well as company to company, especially published insurance loss ratios, which are used by investors. The users of our financial information would suffer from this lack of understandability.

More troubling for us is the anticipated impact on policyholders. Most policyholders who purchase group health and/or life insurance contracts from insurers expect their premium payments to fully transfer specific risks to their insurer. The concept of so called "dollartrading" (as referred to in paragraph 21) is not commonly used in these transactions. By purchasing such contracts, the policyholders are relieving themselves of the transferred risk. Requiring these customers to bifurcate the purchased contract between deposit and insurance elements would require a greater understanding of the group's claim payment history and expectations, which is often not available to these customers. Furthermore, if insurers are asked to provide such information to their customers, this detailed information may lead to exposing their pricing strategy and assumptions to certain customers who purchase fully insured products. To put this concern in perspective, no other industry is required to disclose their pricing strategy by product. Obtaining this information and ensuring its integrity may also raise significant concerns for policyholders that must comply with Section 404 of the Sarbanes-Oxley Act of 2002. Once again, we do not believe the proposal would impact reported net income for a policyholder, but it would drastically change their financial statements and internal controls and require new skill sets to implement accurately. The resulting impacts on financial statement line-item volatility, increased administrative efforts and exposure of competitively sensitive information causes us significant concern.

Issue 4: The flowchart suggests a sequence for analyzing contracts that integrates current insurance accounting guidance with a hypothetical bifurcation analysis. Do you believe that the sequencing and integration are appropriate? What changes would you propose? (page 17)

While we do not agree with the concept of bifurcation as presented in the ITC, we do believe the flowchart to accurately demonstrate the concepts and steps proposed to determine which contracts would be subject to bifurcation.

In general, we support flowcharts and examples to assist implement efforts in any ITC, exposure draft or proposed standard released by the FASB.

Issue 5: Do you agree with the characteristics identified for contracts that do or do not unequivocally transfer significant insurance risk? If not, why not? Should other characteristics be added? Are the examples in Appendix B representative of the discussion in paragraphs 57-59? (page 18)

As we noted in our response to Issue 3 above, we do not agree that group contracts with one policyholder and multiple insureds should not qualify as contracts that are unequivocally insurance. An insurance contract with the corporate policyholder provides a means for the insurance company to offer insurance protection to a group of individuals, permitting an efficient mechanism to pool the transferred insurance risk. Individual policies are priced based on a pooling of risks with other individual policies and should not be viewed differently than a group contract, as the concept of underwriting and pricing is fundamentally the same. For example, individual and group health contracts are purchased by policyholders with the same intent: in exchange for a premium, the insurance company retains the risk (and obligations) of the medical claims incurred. More specifically, both types of policyholders pay for insurance in order to transfer insurance risk. Theoretically, both individual and group health and life insurance contracts subject the insurance company to insurable risk that may result in a range of payments by the insurance company of zero to an infinite amount which is far in excess of the premiums charged.

We believe that the examples in Appendix B reflect the concept of "unequivocal transfer of insurance risk" as drafted in the ITC, however as noted previously, we do not agree with the concept.

Issue 6: Do you think the characteristics described in paragraph 58 for unequivocal insurance contracts are an improvement over the exemption from cash flow testing in paragraph 11 of Statement 113 (summarized in paragraph 37(c) of this Invitation to Comment)? (page 18)

We do not agree with the characteristics in paragraph 58, subparagraphs (a) through (c), as we do not agree with the proposed distinction between an individual and group contract (refer to our responses to Issues 3 and 5). Subparagraphs (d) through (f) of paragraph 58 are agreeable and would represent an improvement over the cash flow testing of FAS 113, because these would result in a more subjective analysis of insurance risk, which is more closely aligned with current practice.

Issue 7: Do you prefer Approach A or Approach B for identifying contracts subject to bifurcation? Why? Do you believe that another approach would be superior? If so, how would you describe that approach? Would your preferred approach be operational? Would it make financial statements more decision useful? (page 20)

After evaluating numerous insurance contracts provided by health and life insurance companies, we could not identify an example of a contract that, if bifurcated between insurance and deposit elements, would overcome the detrimental effects of bifurcation identified in our response to Issue 3 above.

However, should the FASB proceed on the issue of bifurcation, we believe that bifurcation should only apply to contracts in Approach A. These contracts have significant financing components that could lead a user to believe that they should not qualify for traditional insurance accounting. Because of characteristics such as the return of premium features of experience rated contracts, there are cases where future premiums (not current) may be adjusted based on current year claims experience. However, we note that the return of premium features of these contracts are usually a small percentage of the premium earned by the insurer and the return of premium feature is usually not triggered until the renewal of the policy. Therefore, the bifurcated portion of these contracts may not be significant.

We are concerned that the use of Approach B would result in *all* contracts qualifying for bifurcation thus would require a significant amount of analysis for a broad range of contracts. The risk is that contracts that should not be bifurcated will be forced into this category. As preparers, we continue to struggle with overly inclusive approaches (e.g. FIN 46: Consolidation of Variable Interest Entities) to defining the scope of a standard, particularly when the required accounting is complex and difficult to implement and maintain.

Issue 8: Should the criteria for bifurcation be different for insurance contracts and reinsurance contracts? Why? If yes, what differences would you suggest? (page 20)

Insurance and reinsurance contracts both involve the transfer of a risk from one party to another and as such are the same in substance and should be treated the same for accounting and reporting purposes. Therefore, if the FASB decides to proceed with bifurcation (aside from our issues with bifurcation as noted in this letter), we believe it should be applied to both insurance and reinsurance contracts.

Issue 9: Which of the methods identified in this Invitation to Comment for bifurcating insurance and reinsurance contracts do you believe has the most conceptual merit? Please explain. Please describe any additional bifurcation methods that you believe should be considered. Would corporate policyholders encounter unique implementation problems in applying any of the methods discussed in this Invitation to Comment? (page 22)

We do not believe that the bifurcation of insurance contracts would result in improved financial reporting. It does not provide useful information to users as this accounting does

not fully represent the underlying economic substance of the transaction. However, if the FASB decides to continue to pursue bifurcation, we tentatively believe that the proportional method would appear to be the most appropriate technique. This method would require the insurer to bifurcate a contract based on a proportion of premium dollars to the risk that a policyholder maintains before consideration of insurance. We assume that the total risk transferred is determined based on a range of possible payments under the insurance contract; hence a traditional insurance contract (with no risk-limiting features) would not have a material deposit component when bifurcated under this method, as the ratio of premium to risk transferred is close to zero

126

We do not believe the expected payout method, which is based on a relatively short historical period of claim payment history is appropriate, as this model would prescribe that historical claim experience is indicative of transferred risk, which is not necessarily true. Additional guidance would be required to fully evaluate this model, as significantly different assumptions could be developed depending on the grouping of contracts used to develop the models of expected claim payments.

We could not understand or model the cash flow yield method to short duration insurance contracts such as health insurance. This model may be more applicable to long duration contracts where investment returns are a critical component of the insurance contract. We ask the FASB to provide additional guidance concerning the application of this model in order to determine the usefulness and applicability to the bifurcation of insurance contracts.

More guidance on the application of these methods would need to be evaluated. We believe the FASB should provide examples of both "day one" and "day two" accounting for these models. We believe that the examples of "day two" accounting (as mentioned above) would illustrate many of our practical concerns with the concept of bifurcating an insurance contract.

Issue 10: Would data availability limit the development of any of the bifurcation methods discussed in this Invitation to Comment? To what extent are the models that would form the basis for these methods used to underwrite and price products? Would data availability (or lack thereof) affect only certain insurance forms, products, or lines of business? If so, which ones and why? (page 23)

Data availability would limit the implementation of all bifurcation methods and the resources needed to gather and track this information could not be obtained without undue cost and effort by our companies, particularly policyholders that may not have the appropriate historical and projected claim payment patterns. For long tail incurred-basis coverage (versus claims-made coverage), claim information would have to be tracked for many years, in some cases for several decades for lines such as product liability and pollution. This information would not only need to be tracked by the deposit/risk buckets by policy, but would also need to be tracked by legal entity, increasing the amount of the effort exponentially. For example, a CCR-member company has policies which cover its parent and all subsidiaries. Currently, that company allocates premium expense to the subsidiaries covered by the policy, and amortizes the premium expense over the policy period. If that company were to bifurcate the contract, it would need to track deposit versus insurance components of the contract not just for the one individual policy, but for up to 50 policy/entity combinations per policy.

Considering the number of coverage lines, the policy/entity combinations, and the long tail nature of the coverage, this would create significant administrative burdens.

Also, in order for a policyholder to appropriately account for a bifurcated contract, an insurer will have to provide the customer with additional information that they currently do not provide their clients. Some of the additional informational needs would require the insurer to provide the customer with claim payments on a policy basis to ensure that the customer deposit is actually tracked, incurred but not yet reported ("IBNR") and other claim reserve information so that the customers can track their claim activity and appropriately record their own claim activity, etc. Ultimately, it is not clear exactly what information will be required to be tracked and shared with customers to fully implement such a model; however we are concerned with the sharing of potentially competitor/price-sensitive data. However, if this information is not provided by the insurer, then the customer would be required to develop their own actuarial assumptions which could result in identical policies being treated differently by policyholders. The resulting divergence in this accounting between the policyholder and the insurer would clearly not lead to better or more accurate accounting and reporting.

Issue 11: In view of the IASB's project on insurance contracts, should the FASB be considering bifurcation of insurance contracts based on transfer of insurance risk? (page 24)

The original intent of the FASB/IASB Joint Insurance Project was to allow the IASB to lead the project until a standard was developed, at which point the FASB would review the proposed standard to determine whether it would be acceptable as a replacement of the current insurance accounting model under US GAAP. We believe this plan should be adhered to and that no significant proposals to change the insurance accounting model should be made until the completion of Phase II of the Insurance Project. We believe if the FASB is to address insurance accounting at this time it would be prudent to concentrate on the definition of risk transfer under FAS 113 due to recent abuses of insurance accounting rather than a complete overhaul of the insurance accounting model.