AMERICAN RE
A Member of the Munich Re Group

M. Steven Levy, CFA
Senior Vice President &
Chief Financial Officer

August 22, 2006

* 1 3 2 5 - 1 0 0 *

LETTER OF COMMENT NO. 16

Technical Director
File Reference No. 1325-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Invitation to Comment on Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting (File Reference No. 1325-100)

Dear Technical Director:

We appreciate the opportunity to review and respond to the Financial Accounting Standards Board's (FASB) Invitation to Comment (ITC) on *Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting.*

American Re-Insurance Company, a member of the Munich Re Group, is one of the leading providers of non-life reinsurance in the United States. Through our subsidiaries, we write treaty and facultative reinsurance, primary insurance, and provide related services to insurance companies, other large businesses, government agencies, pools and other self-insurers. Effective September 5, 2006, American Re-Insurance Company's name will change to Munich Reinsurance America, Inc. The Munich Re Group, whose business also includes primary insurance and asset management, has a preeminent position in the global reinsurance industry. It is headed by Munich Reinsurance Company of Munich, Germany, and includes reinsurance subsidiaries, branches, service companies and liaison offices in more than 60 locations worldwide, serving corporate clients from more than 160 countries.

We support the Board's continued efforts to improve financial reporting and provide financial statement users with better decision-useful information regarding the economic substance of insurance and reinsurance transactions. We also support the Board's goal of achieving convergence between U.S. GAAP and International Financial Reporting Standards. We believe that the alignment of any proposed GAAP guidance with the planned joint efforts of the FASB and the International Accounting Standards Board are critical to achieving that objective. Finally, we believe that any proposed changes to the current accounting guidance should be cost justified and made in a manner that is consistent with the Board's stated objectives of simplifying the accounting literature and providing a principles-based accounting framework.

It is our belief that the current accounting guidance provides sufficient detail for auditors and other practitioners to make reasoned judgments on risk transfer and that the current insurance accounting model is not in need of the significant adjustments contemplated by the current Invitation to Comment. We do not believe that the proposed rules-based framework and bifurcation approaches detailed within the ITC will meet the FASB's objectives to improve the decision-usefulness of reported financial information for insurance and reinsurance transactions. In addition, we feel that implementation of the proposed rules in the ITC will actually result in significant changes that will prove costly and negatively impact the value of GAAP reported information for financial statement users, analysts and rating agencies.

We strongly believe that the FASB should collaborate with the National Association of Insurance Commissioners (NAIC) and the actuarial profession to more explicitly define and improve alternative approaches and metrics for risk transfer testing which can be applied within the framework of the existing principles-based accounting guidance. We believe that such an approach would improve the transparency, consistency and ease of application of the current accounting guidance in light of the diversity, complexity and types of reinsurance transactions in the marketplace. In addition, the FASB could consider expanding GAAP disclosures for material ceded reinsurance contracts that transfer minimal amounts of risk, similar to those recently adopted by the NAIC.

Our detailed comments relating to the specific questions included in Appendix A of the Invitation to Comment are set out in the attached document and provide additional examples and support for our conclusion and the above recommendations. We appreciate the opportunity to share our comments and ask that the FASB consider our views and observations in further deliberations on these very important issues.

Sincerely,

M. Steven Levy, CFA
Senior Vice President and
Chief Financial Officer

Craig Howie, CPA, ARe
Vice President and Controller

Comments on the FASB Invitation to Comment "Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting"

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?

We believe that the current IFRS 4 definition of an insurance contract provides sufficient detail to properly identify and distinguish insurance and reinsurance contracts from other financial contracts.

It is also our view that the current GAAP definition of insurance risk, as detailed within SFAS 113 for reinsurance contracts, provides sufficient principles-based guidance and a reasoned approach to adequately distinguish insurance risk from other financial risks. While we believe that current IFRS and GAAP guidance are consistent in their intent, we acknowledge that the more stringent concept of "indemnification" or reimbursement of a loss as detailed within GAAP guidance, is fundamental to the current U.S. industry accepted definition and interpretation.

The descriptions of "finite" insurance and reinsurance contracts, including the risk-limiting features (in ITC paragraph 36), do not adequately identify and differentiate those contracts since these features are common to most insurance and reinsurance agreements (i.e. policy limits, adjustable features, multi-year contracts, etc.). The limitation of risk is a normal and necessary element of providing insurance and reinsurance, as the assumption of unlimited exposure to liability may carry severe financial implications. It is common practice for an insurance or reinsurance company to limit its contractual liabilities, in order to protect its capital base and claims paying ability. We believe that risk-limiting features should be viewed as an imperative of a responsible risk management strategy, not an attempt to conceal the economic substance of a contract.

We would not suggest any changes or improvements to the definitions and descriptions of "finite" presented within the ITC because we do not believe that it is practical or useful to do so within the current accounting literature. We do not believe that a laundry list of rules-based features is appropriate in developing accounting standards. The development of rules-based standards will limit the application of professional judgment and create more opportunity for circumvention through financial engineering and arbitrage, as well as invite the abuse of form over substance. Nevertheless, we acknowledge that the presence of certain risk-limiting features with economic equivalence may be useful for identifying contracts which should require risk transfer testing or in determining the scope of additional financial statement disclosures, which is consistent with the approach recently taken by the NAIC and the insurance rating agencies.

We believe that current accounting guidance provides an adequate framework for defining the elements of risk transfer that are required to permit reinsurance accounting treatment, regardless of specific contractual features. We feel that enhanced practical guidance regarding alternative risk transfer testing approaches and metrics for evaluating sufficient risk transfer should be considered. Current work underway at the NAIC and within the actuarial profession could be leveraged in this effort. In our view, such an approach would improve the transparency, consistency and ease of application of the current accounting guidance, while recognizing the diversity, complexity and types of reinsurance transactions in the marketplace. In addition, the FASB could consider expanding GAAP disclosures for material ceded reinsurance contracts that transfer minimal amounts of risk, similar to those recently adopted by the NAIC.

Finally, we view the current U.S. GAAP definition of insurance and insurance risk as more than adequate under the current deferral and matching accounting model. We believe that any significant changes to the U.S. GAAP definitions and accounting model for insurance and reinsurance should only be addressed in the context of the ongoing efforts towards convergence with International Financial Reporting Standards.

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?

We believe that the existing principles-based guidance in SFAS 113 results in accounting treatment that accurately reflects the economic substance of reinsurance transactions. We do not believe that it would be practical to apply this guidance to transactions between corporate policyholders and insurers and do not feel that such an approach would provide for improved decision-useful financial information.

The application of the risk transfer guidance of SFAS 113 requires extensive actuarial expertise in assessing the probability of loss, as well as the use of comprehensive historical data that is typically not easily available to corporate policyholders. We do not believe that most corporate policyholders would have the capability and data necessary to adequately prepare cash flow analyses required for the often complex requirements of risk transfer testing.

We feel that the ITC incorrectly infers that information regarding the amount of insurance premium incurred by corporate policyholders would be decision-useful. We believe that classifying a portion of insurance premiums and recoveries as deposits is unlikely to result in decision useful information for the users of financial statements since insurance premiums, insured losses and insurance recoveries are immaterial to the financial statements of most corporate policyholders, and are aggregated in selling, general and administrative expenses without separate disclosure. In addition, the amount of insurance premium recorded will provide little or no insight about the risks transferred or risk retained by a corporate policyholder. For example, the same amount of premium cost could be incurred for insuring a lesser amount of an exposure that is more likely to occur as for insuring a much larger (e.g. catastrophic) amount of an exposure that is much less likely to occur. In addition, an individual policyholder's premium expense may increase dramatically year to year due to insurance industry experience cycles that dramatically change the price of coverage. The end result is that premium expense is often not comparable between companies or even for a single company year to year. The ITC proposal to segregate premium amounts from deposits through bifurcation will not make this information more relevant to users or provide more predictive value regarding potential insured or uninsured exposures.

Finally, we believe that the issue of comparability should be considered in the application of FAS 113 and the bifurcation proposals in the ITC, as it relates to corporate policyholders. Assuming that corporate policyholders could evaluate risk transfer and apply the onerous bifurcation analysis and methods as proposed within the ITC, we believe that differences in risk evaluation capability and access to data would likely result in corporate policyholders reaching very different accounting treatment conclusions from insurers on the same transaction. This would not provide any additional benefits to the understandability or decision-usefulness of policyholder or insurer financial statements.

In summary, we do not believe that the Statement 113 guidance should be modified or clarified to apply to transactions between corporate policyholders and insurers for the above mentioned reasons.

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?

We believe that bifurcating insurance and reinsurance contracts would not provide more understandable and decision-useful information than the current GAAP model, which preserves the traditional measure of insurance premium for contracts that transfer enough insurance risk to be accounted for wholly as insurance or reinsurance. The following discussion points support our conclusion.

We feel that bifurcation, as proposed in this ITC, would require significantly more complex and arbitrary estimates and assumptions. The concept of bifurcation, as proposed within the ITC, implies a level of precision that belies the complexity of insurance and reinsurance pricing and loss estimation. The proposed approach and methods will likely result in an artificial bifurcation which would not accurately represent the economic substance of the transaction, could result in more varied practice than currently exists and a greater disparity of practice among insurance and reinsurance companies. This would have the effect of significantly increasing variability and further distorting the reliability and comparability of the reported financial information.

The ITC proposes rules-based standards which will limit the application of professional judgment and create more opportunity for circumvention. We believe that the overly specific GAAP guidance, as proposed in the ITC, significantly increases the risk of form over substance issues.

The ITC presumes a single-risk view which is inconsistently applied and in conflict with the way a typical insurance or reinsurance company evaluates and manages risk. Insurance and reinsurance contracts are designed and priced as packages, to efficiently transfer insurance risk from one party to another (not to achieve a particular accounting result). Traditional insurance and reinsurance contracts have loss limiting, adjustable, multi-year and other features to allow the issuer of the policy the ability to protect its capital base/claims paying ability and to provide the purchaser an economically feasible way to spread and transfer risk over the larger capital base of the insurance and reinsurance industry at an affordable price. Bifurcation of some elements of these transactions is an artificial construct that fails to recognize the interdependent relationship of the contract components.

There are other comparability problems with respect to the way the ITC defines contracts that unequivocally transfer risk and thus may not be subject to bifurcation. For example, the ITC defines a single contract for a single risk as unequivocal (not requiring bifurcation). Yet, an aggregation of similar contracts (because it arguably has an expected loss) would be subject to bifurcation. In addition, a straight Quota Share reinsurance contract pays losses on the individual contracts (not on the aggregation of those contracts) and thus is economically identical. However, the ITC would require bifurcation of the reinsurance contract and not the underlying contracts. This approach will create inconsistent accounting for identical economic transactions. To cite another example, because many commercial insurance contracts have loss limiting features that would require bifurcation, the financial statements of a personal lines writer could look completely different than that of a commercial writer of insurance. In addition, reinsurers and commercial insurers would be required to bifurcate many of the insurance contracts issued and would also be required to bifurcate most ceded reinsurance contracts. However, a personal lines insurer would likely only be required to bifurcate outgoing reinsurance. Since the economics of these transactions are not fundamentally different, this is not a rational and consistent approach.

Understandability of common balance sheet and income statement items, as well as common insurance ratios will be less relevant and have less predictive and confirmatory value than under current U.S. GAAP. Furthermore, bifurcation of insurance and reinsurance contracts, as proposed in the ITC, would make useless many ratios that are commonly used by insurance industry observers. Loss ratios, expense ratios, combined ratios and leverage ratios are all based on written or earned premiums. These ratios are very useful to gauge the relative performance and profitability of insurers and the quality of management. Grossing up the balance sheet for the financing elements of portions of insurance and reinsurance contracts will come at the price of losing much more valuable analytical information to the financial statement users.

The qualitative characteristics of relevance, reliability, and comparability, as well as consistency in application of accounting treatment are critical to ensuring that the economics of transactions are faithfully represented in the financial statements and provide understandable and decision-useful information. We believe that current accounting guidance for insurance and reinsurance does provide a principles-based model that, when properly applied, accurately reflects the economic substance of these transactions. It is a principles-based standard that has resulted in clear and concise reporting of insurance and reinsurance under the current U.S. deferral and matching model for insurance. The ITC is far more likely to result in an accounting model that is difficult to properly apply than current GAAP. As previously stated, we also believe that the resulting financial information will be less clear and concise than current U.S. GAAP.

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?

We view the introduction of both additional "bright line" rules and ambiguous tests within the flowchart as problematic. Current accounting rules follow a single test approach for determining the accounting treatment of a contract (i.e. risk transfer test of SFAS 113). A hypothetical bifurcation based on the proposed flowchart introduces further rules and tests that will not lead to an improvement in the financial accounting of insurance contracts. Attempts to further separate reinsurance contracts that unequivocally transfer significant insurance risk from contracts that do not, will introduce substantial subjective judgment on the part of financial statement preparers, will complicate the accounting for insurance and reinsurance contracts, as well as impair the comparability of financial statements.

It is not clear where the existing principles-based standard in SFAS 113 has an operable place in the proposed model. One problem with the sequence of the flowchart is that contracts that do meet the risk transfer threshold of SFAS 113 would still be subject to possible bifurcation; however, contracts that do not meet the risk transfer threshold would be accounted for as a deposit in their entirety. This is not consistent with the overall bifurcation approach contained in the ITC and ignores the possibility that the insurance component may be material even though the overall contract fails the SFAS 113 test. This could further distort results if the premium relating to this "pure" insurance element is not included in the income statement of the reporting entity. Finally, the fourth screen (e) has not been defined but is contemplated to be a rules-based requirement based on either specified contractual terms or features, or contracts described or defined as "finite" risk contracts. We believe it will be exceedingly difficult to define "finite", which we view as dependent on the degree of economic impact rather than specific features that are also typically common of "traditional" reinsurance contracts.

In summary, we believe the flowchart renders the current SFAS 113 risk transfer tests irrelevant while introducing both "bright line" rules and further ambiguous tests that will complicate the accounting for insurance contracts and not lead to improved decision-useful financial information.

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?

We do not agree with the characteristics identified for contracts that do or do not unequivocally transfer significant insurance risk. The characteristics identified in the ITC narrowly define unequivocal risk transfer with a set of rules-based criteria that either cannot be effectively measured or consistently applied. For example, it is not clear how the ITC reference to "market equivalent level of premium" or "standard market terms" would be defined, measured or applied. In addition, according to the detail in paragraphs 57 – 59, only single risk insurance contracts would be eligible for unequivocal risk transfer. Therefore, under the proposed rules, it is likely that an insurer would apply the test on the basis of each personal/commercial insurance contract in its overall portfolio and would come to the conclusion that many contracts unequivocally transfer significant insurance risk (in the absence of other factors). The reinsurer (assuming part of the insurer's portfolio via an unrestricted quota share contract), would bifurcate the same transaction on the basis of failing to meet the unequivocal test. There appears to be no theoretical justification of the different accounting treatment, since the portfolio of risks held by the reinsurer and insurer in this example are identical. The proposed characteristics do not account for the diversification effects that are experienced from the aggregation of risk by both the ceding insurer and reinsurer.

We do not believe that this approach will ever result in consistent accounting for similar economic events or substitute for the professional judgment that is necessary to adequately evaluate the complexities of accounting for insurance and reinsurance.

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)?

We do not believe that the characteristics described in paragraph 58 for unequivocal insurance contracts are an improvement over the paragraph 11 exemption of SFAS 113. The specific contract types and characteristics in paragraph 58 of the ITC are used as a narrow rules-based filter for contracts with negligible non-insurance features for insurance accounting treatment. The paragraph 11 exemption of SFAS 113 requires professional judgment to evaluate whether the reinsurer has assumed substantially all of the insurance risk relating to the reinsured portions of the underlying contracts. Based on the proposed ITC rules, further testing and evaluation of most reinsurance contracts that meet the current paragraph 11 exception would be required because the only reinsurance contracts that would appear to qualify are single risk facultative contracts. The existing principles-based guidance is more effective as it requires professional judgment to evaluate the substance of the reinsurance arrangement regardless of form.

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?

We do not prefer either Approach A or Approach B for identifying contracts subject to bifurcation. Both approaches rely on specific rules to determine the existence of "significant" risk-limiting features which result in the bifurcation of a contract. Applying such rules will require bifurcation of many "traditional" insurance and reinsurance contracts that transfer significant risk simply because of the existence of a contractual feature.

We do not believe that the bifurcation approaches proposed in the ITC would result in improved decision-useful financial information and reiterate that the current principles based approach has worked well for the vast majority of transactions.

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

We do not believe that the bifurcation proposal is feasible or will provide more understandable and decision-useful information for the accounting of insurance or 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?

None of the methods are presented in sufficient detail to allow for an adequate analysis and evaluation of the impact. However, it is clear that all of the bifurcation methods described will increase the complexity and inconsistency of insurance and reinsurance accounting by requiring more arbitrary judgments and assumptions.

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?

Data availability would limit the development of the bifurcation methods discussed in this ITC. All of the bifurcation methods described within the ITC would likely require significant changes to pricing models, accounting systems, and management processes that do not appear to be cost justified.

Data limitations would be more significant for specialty lines of business than standard lines such auto, property and general liability lines of business. For similar reasons, data availability would also limit the application of the bifurcation methods described in this ITC for insurance buyers, who are not in the insurance business and would not have access to sufficient or reliable data. It is also unlikely that these entities would have the necessary expertise to evaluate risk transfer, much less make decisions on how to bifurcate various elements of insurance contracts.

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?

In view of the current planned efforts between the FASB and IASB regarding international convergence of accounting standards, we do not believe that bifurcation should be considered by the FASB. The IASB phase II project for insurance contracts is currently steering towards a "current-value" approach that would treat insurance contracts similar to other financial instruments. If the FASB adopts a recognition and measurement approach for insurance contracts which is similar to the proposed IASB model, the implementation of the significant changes proposed within the ITC would only serve to require multiple costly changes within a relatively short period of time and may jeopardize future attempts to develop reliable and globally converged accounting standards.