

August 21, 2006



LETTER OF COMMENT NO. 21

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7
P.O. Box 5116
Norwalk, Ct 06856-5116

Re: Bifurcation of Insurance and Reinsurance
Contracts for Financial Reporting
File Reference No. 1325-100

I respectfully oppose attempts to bifurcate insurance and reinsurance contracts for the following reasons:

1. Practically speaking, bifurcation of contracts would effectively mean the end of any experience sensitive contract no matter how insignificant the non-risk transfer portion would be. Administration difficulties would become complex. Companies would be forced to eliminate any contract with experience sensitivity. This would be unfortunate, as experience sensitive contracts align the interest of policyholder and insurer and insurer with reinsurer, and create an atmosphere conducive to the encouragement of safety and loss reduction. Lack of monetary incentives for effective loss control would have a chilling effect on altruistic activities that benefit both parties and others as well.
2. In insurance and reinsurance, we are always dealing with varying degrees of the unknown; whereby there is no such thing as one readily determinable actuarial sound rate. Different policyholders and ceding insurers have nuances to their level of risk that are not taken into account utilizing standard rating criteria. Profit sharing or experience sensitive contracts provide added actuarial precision to the rate than guaranteed cost product priced solely on a prospective basis.
3. Loss sensitive products enhance the partnership relations among the parties. Lack of loss sensitive products would discourage risk taking on the part of insurers and reinsurers and inevitably lead to higher ultimately priced guaranteed cost products or, in the alternative, more self-insurance. More self-insurance would lead to less accurate financial statements on the part of policyholders who cannot factor in future development risk into their current financials.

4. I see nothing in your proposal to exempt reciprocal pools whereby the experience of the entire pool determines the amount of return premium (or additional premium) that is due when the experience of the group is known. Will assessable mutuals, risk retention groups, and reciprocal reinsurance pools be required to engage in deposit accounting when experience of the group potentially could result in non-risk transfer for individual policyholders?
5. Bifurcation would not lead to more accurate financial statements. It would only lead to complexity and less transparency. If you want to crack down on some of the more gray area finite deals, come up with specific criteria that are not subject to wildly different interpretations, i.e., not over 75% difference in ultimate premium costs from prospective costs attributable to policyholder (or insurer in the case of a reinsurance contract) loss experience.
6. It is not practically possible to bifurcate higher retentions such as increased deductibles or loss corridors. In fact, higher retentions tend to reduce non-risk transfer elements requiring higher risk charges in relation to total premium.
7. As I read the Unequivocally Transfer Insurance, it appears that the degree of predictability in loss experience is being opened for interpretation and second guessing. This has historically been the purview of underwriting and not the province of accounting. The law of large numbers should not be confused with non-risk transfer. Larger risks generally receive upfront premium credits that offset the increased predictability of a given risk. If you eliminate individual insurer or policyholder loss rating, you are eliminating much of what is considered insurance and practically all of what is considered reinsurance today.
8. If standard quota share contracts today lack substantial risk transfer, why do many reinsurers only write excess of loss reinsurance? Could it be that underwriters perceive that primary rate adequacy is so uncertain and tenuous that it is too great a risk to entertain?
9. Reinsurance is often used for the purpose of granting greater capacity to write business. To the degree a quota share has stable prior experience, are you then going to have accountants determine that a portion of that quota share has no risk transfer component? Prospective margin requirements have historically been predicated on the perceived degree of potential variability in results.

Thank you for the invitation to comment on this proposal.

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