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VICE PRESIDENT, FINANCIAL LEGISLATION
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August 21, 2006

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

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

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to respond to the FASB's Invitation to Comment ("ITC") on Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting. PCI is the nation's largest full-service property casualty insurance trade association, with over 1,000 members writing over \$194 billion in direct written premiums, over 40 percent of the U.S. property/casualty insurance market. Many of our members are publicly-traded companies, and many others are non-publicly owned insurers that file GAAP statements for various purposes.

Before we respond to the specific issues raised in the ITC, we would like to state our belief that current GAAP guidance with minor changes continues to be appropriate and should continue to be the basis for general purpose accounting for insurance and reinsurance contracts. PCI believes that the ITC's bifurcation proposal would be a major step backward toward the type of rules-based accounting system that members of this Board and other accounting standard-setters have severely criticized. It may, however, be appropriate for the FASB to review work being performed by the actuarial community regarding risk transfer testing under Statement of Financial Accounting Standards No. 113 – Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts (Statement 113), and additional disclosure may in some cases also be worth examining.

<u>Issue 1:</u> 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?

PCI agrees that IFRS 4 provides a good working definition of "insurance contract", except that the concept of indemnification of the insured should be added. We also agree that the GAAP definition of insurance risk in Statement 113, paragraph 121, is appropriate. For the reasons set forth below, we do not believe that GAAP guidance needs to contain definitions and descriptions of finite insurance and reinsurance contracts.

<u>Issue 2:</u> 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?

PCI believes it would be both unnecessary and extremely difficult for corporate policyholders to apply the Statement 113 risk transfer guidance to ordinary insurance contracts. In the great majority of cases, there should be no question that commercial insurance policies transfer significant insurance risk under current GAAP guidance. In the rare cases where there is a question, we doubt whether reclassifying contracts as deposit arrangements will be material to business policyholders' financial statements. Premiums paid by policyholders are not necessarily a helpful method for users of financial statements to measure the risk that those policyholders are assuming or retaining. In return for minimal if any gain in understanding policyholder

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financial statements, we note the application of Statement 113's risk transfer test often requires significant amounts of data to which commercial policyholders may not have access, and actuarial and stochastic modeling expertise that they likely do not have.

In concept there may be no reason why the risk transfer analysis for insurance and reinsurance contracts should be significantly different. We believe that the current GAAP guidance for insurers works well, however, and significant change at this point will not increase the clarity and comparability of insurer financial statements.

<u>Issue 3</u>: 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?

PCI opposes the bifurcation of insurance or reinsurance contracts into insurance and deposit components for two major reasons. We believe the ITC's approach would decrease the transparency of financial statements for both policyholders and insurers, and produce less understandable and decision-useful information for financial statement users, at significantly greater cost for preparers. The current accounting for insurance contracts is well understood by both preparers and the users of their financial statements. In contrast, the ITC's approach would call into question the treatment of any contract with any level of expected payment of losses to the policyholder. The potential bifurcation of any group contract, most reinsurance contracts and most commercial insurance contracts will add significant costs to policyholders and insurers, we believe, without improving anyone's fundamental understanding of the economics of most insurance contracts. Substantial judgment would also have to be applied in the use of any of the "possible bifurcation methods" proposed in the ITC. For this reason users would have a very difficult time understanding bifurcated information, as we believe that practice would be significantly different among preparers as they decide which contracts should be bifurcated and how to apply the bifurcation method chosen. Policyholders and insurers, and insurers and reinsurers, will also have a greatly-increased likelihood of making different judgments about the same contracts than is the case now. Bifurcation will increase, not reduce, the use of judgment by preparers and their auditors, and will therefore decrease the comparability of policyholder and insurer financial statements. We believe that its additional complexity will also create restatements, and could be a breeding ground for unnecessary litigation.

PCI also believes that the fact that insurance contracts are viewed as a whole by policyholders, insurers and reinsurers argues against bifurcation. There is an expected loss inherent in <u>any</u> insurance contract, at least from the insurer's standpoint (even in the case of individual auto coverage, for example, there is a per-driver or auto expected loss, otherwise the insurer would be unable to price the product). But the actual loss events — which may be significantly different from expected losses — and the amounts and timing thereof are fortuitous, and we believe that this requires that the contract be considered as a whole. Another significant difference is that, unlike a deposit, the policyholder or ceding insurer has no right to receive its money back until a subsequent event — suffering the loss insured against — occurs. And it is difficult to understand how financial statement users' understanding of policyholders' and insurers' financial statements will be increased by a procedure that characterizes contracts in a manner that is contrary to the common understanding of insurance contracts. The more likely results are increased confusion, and increased expense incurred in arriving at that confusion.

PCI understands that contracts exist where there is a significant question as to whether sufficient risk transfer has occurred. These situations call for difficult judgments to be made by preparers, auditors, actuaries and users. We believe that those judgments are necessary, however, and cannot be made easier or more correct by developing a series of rules to split contracts that are negotiated and understood as a whole into separate parts. As we have pointed out above, we believe that bifurcation will significantly increase the number of situations where these types of judgments are required.

<u>Issue 4:</u> 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?

PCI does not believe that the flowchart is helpful. For reasons we will explain below, we do not think that the "unequivocally transfer" test is appropriate, and we have already described why we do not believe that application of the Statement 113 test to most direct insurance contracts will work.

<u>Issue 5:</u> 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?

PCI believes that the "unequivocal test" in paragraphs 57-59 is substantially too restrictive to be an appropriate "screen" for the types of contracts that would require additional scrutiny, even in the absence of a bifurcation requirement. The ITC's proposed test would require risk transfer analysis for all group business, most reinsurance contracts and most large commercial insurance contracts. We do not believe that such a test would satisfy the ITC's concern about "reduc(ing) the cost imposed on preparers in instances where further risk transfer analysis . . . would provide little or no additional useful financial information to users."

<u>Issue 6:</u> 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)?

No, for the reasons we have described above.

<u>Issue 7:</u> 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?

For the reasons set forth above, we believe neither Approach A nor Approach B will make financial statements more decision useful.

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

Again, we suggest that bifurcation of either insurance or reinsurance contracts is inappropriate.

<u>Issue 9:</u> 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?

We believe that corporate policyholders would encounter significant implementation problems in applying any of the bifurcation methods set forth in the ITC, and do not believe that any of them should be considered.

<u>Issue 10:</u> 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?

Although PCI is a trade association of insurance companies, we suspect that very few policyholders have collected or retained the data necessary to apply either the "expected payout" or "proportional" methods. In any case, we believe that none of these methods is appropriate.

<u>Issue 11:</u> 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?

PCI notes that the IASB is near the release of a "discussion paper" summarizing its tentative decisions on insurance accounting, which contain substantial differences from current GAAP, and that the FASB intends to solicit comments from its constituents in an ITC. We strongly question the need to institute a significant change in a portion of U.S. insurance accounting just before considering a proposal that will likely recommend a substantial restructuring of the entire accounting system for insurers.

If you have any questions about our comments or issues you would like to discuss, please contact me at your convenience, by phone at 847.553.3606 or by email at steve.broadie@pciaa.net.

Sincerely,

Stephen W. Broadie

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