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LETTER OF COMMENT NO. 15

Mr. Robert Herz
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Dear Mr. Hertz

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

We appreciate the opportunity to comment on the Invitation to Comment (“ITC”). The ACE Group of Companies provide a broad range of insurance and reinsurance products to insureds worldwide through operations in more than 50 countries around the world, and have the authority to conduct business in over 140 countries. ACE Limited, the Bermuda-based holding company of the ACE Group of Companies, is publicly traded on the New York Stock Exchange. Given our global presence and public reporting responsibilities, we are very interested in the development of a single global insurance accounting standard and the potential effect it will have on public reporting. Historically, the majority of our business has been property/casualty or non-life products.

We believe it is preferable to have one global accounting standard for insurance contracts. However, we believe this should only be undertaken if a new global standard is clearly superior to current U.S. GAAP. While the current U.S. GAAP model for insurance contracts can be improved, in our view, the current exit value model proposed in the IASB’s Discussion Paper, *Preliminary Views on Insurance Contracts* (“DP”) does not represent an improvement to current U.S. GAAP, particularly with respect to non-life insurance contracts. Specifically, we believe the IASB has provided too much importance to the use of fair value to measure insurance liabilities and insufficient importance to fundamental objectives of financial reporting, such as decision usefulness, reliability, relevance, comparability, and consistency. Further, the DP does not sufficiently consider practical aspects of the insurance business and the most meaningful means to report accurate and useful financial information to the public. Therefore, we believe it is imperative for the FASB to have more direct input into the insurance standard.

The questions (in italics) contained in the ITC and our comments to those questions follow.

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



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Yes. We believe a global insurance accounting standard is an appropriate goal and would be best for the worldwide insurance industry. However, for the benefit of users of insurers' financial statements and the capital markets, it is most important that such a standard clearly be an improvement to current U.S. GAAP. If it is not, it would be best to forego a global accounting standard for insurance contracts and maintain a separate accounting basis for U.S. GAAP. 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.

a. What aspects of existing U.S. GAAP accounting for insurance contracts could be improved or simplified and how pervasive are these issues?

Two areas of improvement include:

- 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.
- 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.

b. How important is the development of a common, high-quality standard used in both the U.S. and IFRS jurisdictions?

It is a desirable objective but should not be undertaken if the global standard is not an improvement to current U.S. GAAP. In contrast to the current exit value model in the DP, the new global standard must focus on the income statement as well as the balance sheet. Further, the income statement must enable the user to best assess operating performance of an insurer both relative to prior periods and relative to peer companies.

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?

No, we believe current U.S. GAAP is a better starting point. The inclusion of risk margins and discount into the liability measurement for non-life contracts will clearly not simplify financial reporting relative to U.S. GAAP. Further, we believe the model proposed in the DP, particularly as it relates to the valuation of non-life claim liabilities, is not an improvement to U.S. GAAP given our following beliefs:

- Current exit value or fair value should not be the single measurement-basis for all assets and liabilities and in particular, should not be the measurement-basis for insurance liabilities.



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- The nature of insurance risk differs between a typical life and non-life contract. When evaluating the best accounting model in light of these fundamental differences, we conclude different accounting approaches are necessary. Consequently, there is a need for two accounting models.
- Risk margins should not be included in the measurement-basis for non-life contracts because they cannot be reliably measured as there are too many models that can be used to support risk margins and each model, including the cost of capital method, relies on too many speculative assumptions to be sufficiently reliable for financial reporting.
- When evaluating the most optimal accounting model, one must consider whether the resulting financial information optimizes users' ability to assess operating performance and whether the financial information is sufficiently reliable to support decisions. While not perfect, US GAAP for non-life contracts has proven to be a decision useful and reliable means to measure operating performance. With respect to assessing financial performance of non-life insurance contracts, we believe the current US GAAP is superior to the IASB's proposed model.
- Loss reserve adequacy is critical to the financial status of a non-life insurer. The change in nominal loss reserves, or loss reserve development, provides useful insight into historical loss reserve adequacy for a non-life insurer. Changes in nominal loss reserves from period-to-period can result in considerable earnings volatility. The inclusion of risk margins and discounting will not alter these facts but result in considerable cost and practical issues for preparers that are not commensurate with any perceived benefit to users.

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?

No, we believe the measurement objective which is accomplished through the building blocks in is not feasible to implement. In particular, we have concerns with the inclusion of risk margins that must be reevaluated at each balance sheet date when there is: i) no observable market to validate the risk margin; and ii) the majority of significant inputs in a model to estimate the risk margin cannot be supported by an observable market but instead are based on speculation of the future. Under these circumstances, the output of models used to derive current exit value is apt to be materially different from the price determined by a knowledgeable independent party and therefore inconsistent with the intended measurement objective and not relevant to a user.

Further, management's estimate of claims and related expenses should be based on entity-specific cash flows to settle a claim and not based on "market-consistent" factors that cannot be verified and are irrelevant to assess an insurance company's operating performance.

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?



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In contrast to current U.S. GAAP, we believe a new accounting model for non-life insurance contracts may incorporate the use of probability-weighted averages. This approach better recognizes that the estimate of claims settlement is inherently subjective and there are numerous potential loss scenarios. Because the potential magnitude of adverse development of loss reserves (understating the estimate of future claim payments) generally exceeds the potential magnitude of favorable development of loss reserves (overstating the estimate of future claim payments), we anticipate the use of probability-weighted averages could result in slightly higher industry reserves thereby potentially reducing the extent of adverse development in the non-life insurance industry.

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?

We believe it would be beneficial to address accounting by policyholders, although it should be undertaken after completion of the insurance contracts project. In addition to accounting for insurance contracts, we believe such a project should address accounting for self-insured liabilities. Some accounting issues faced by commercial insureds for which specific accounting guidance could be useful to practitioners include:

- 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.
- The right of offset between assets related to reimbursements from insurance contracts and liabilities related to primary obligations being insured.
- Recognition of premium expense for various types of insurance products.
- Accounting for fronting arrangements in consolidation whereby one affiliate transfers risk to an insurance company a captive insurance affiliate assumes all, or part, that same risk.

However, we believe accounting by insurers should be addressed first and a standard completed prior to addressing accounting by policyholders. There are numerous issues to contemplate when developing guidance for insurers and consequently, adding policyholder accounting to the project would create additional and unnecessary complexity that would only slow the project. Once conclusions are reached for insurance contracts, it would set precedents for policyholder accounting that would facilitate this "second phase" of an insurance project.

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?

We believe these projects and an insurance project should be deliberated in tandem. On one hand, these projects will need to be applied to an insurance model and accordingly, it would be logical to complete



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them prior to finalizing a new insurance model. However, on the other hand, insurance contracts have very unique characteristics relative to other contracts, including financial instruments. Consequently, it is imperative to consider insurance contracts when deliberating basic financial statement concepts because they could necessitate exceptions to general rules. In particular, the FASB should deliberate insurance contracts prior to finalizing the conceptual framework, revenue recognition, and financial statement presentation models as these projects will very clearly influence the accounting model for insurance contracts. To complete these three projects prior to deliberating the accounting model for insurance contracts is apt to result in general guidance that must be applied to insurance contracts yet will not result in the most optimal financial reporting model for insurance contracts. The IASB's DP is an example of this as the proposed fair value or current exit value model is based on basic concepts of the IASB yet is not the most optimal financial reporting model for insurance contracts.

We would be pleased to discuss our comments with you, the FASB Board members, or the FASB staff at your convenience.

Sincerely

A handwritten signature in black ink, appearing to read 'Philip V. Bancroft', written in a cursive style.

Philip V. Bancroft
Chief Financial Officer