

November 16, 2007

LETTER OF COMMENT NO. 2.5

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

Sent via email to: director@fasb.org File Reference No. 1540-100

Re: 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*

Dear Mr. Herz:

The undersigned insurance trade organizations appreciate the opportunity to comment on this Invitation to Comment (ITC). We commend the Financial Accounting Standards Board (the "Board") for asking the appropriate questions in the ITC. From an investor's perspective, it is important that global insurance accounting standards account for similar insurance liabilities in a similar manner. Additionally, there are areas where current U.S. GAAP guidance for insurance contracts should be improved and this would be the appropriate opportunity to enhance such guidance. For these reasons and for the purposes of convergence, we recommend the Board should add a project on Insurance Contracts to its agenda. Although the Board should pursue a joint project with the IASB, we do not believe the IASB's Discussion Paper ("DP") is the appropriate starting point for the Board's deliberations for the many reasons discussed in our response to Question 2 of the ITC in the appendix to this letter. The DP along with the materials used by the IASB to deliberate the DP and other available information including proposals from several insurance trade organizations provide useful information that should be used in deliberating improvements to current U.S. GAAP.

We also request that the Boards develop new insurance standards in conjunction with other significant projects on their agendas (e.g., revenue recognition, performance measurement, etc.), in order to avoid setting a precedent in one project that would result in additional changes to insurance accounting and reporting in the future. The questions contained in the ITC and our detailed comments to those questions can be found in the attached Appendix.

Because the DP proposes to establish one accounting model for <u>all</u> insurance contracts, the undersigned trade associations, which collectively represent many different types of insurance products, came together to express their collective concern that a single model would compromise the representational faithfulness of the unique reporting characteristics of insurance products issued by their members. Accordingly, we reached agreement in drafting this letter and may comment individually by separate letter on areas that are specific to the types of insurance products written by our members.

We realize that our products are economically diverse in nature with varying degrees of complexity and with this in mind, and assuming the Board adds the project to its agenda, we offer our assistance to the Board in whatever capacity the Board believes to be appropriate.

Sincerely

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APPENDIX

Question 1

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

Yes, it is important to have global insurance accounting standards that account for similar insurance liabilities in a similar manner and that, for the purposes of convergence, the FASB should add the project to the agenda as a joint project as soon as possible given the possibility that the SEC may move to allow both foreign filers and U.S. filers to file audited financial statements using International Financial Reporting Standards. If a choice is involved, some filers may select the standard that affords their entity with the most favorable accounting answer for the filer, which may not necessarily be the best answer for investors. Additionally, it will be difficult for analysts and investors to compare the financial statements of companies selecting different standards.

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

There are areas of U.S. GAAP for insurance accounting that could be improved. Overall, a positive start would be to develop a more principle-based framework focused on insurance contracts, as opposed to the current GAAP approach which focuses on the type of company writing the contract. We also believe that the FASB should consider the current IASB definition of insurance contracts, which in some respects appears to more completely consider the economics of the various contracts than the current U.S. GAAP definition.

For short duration contracts, such as those providing property and casualty or many health insurance coverages, the accounting is generally well understood and a significant overhaul is not necessary. However, we do believe that some enhancements could be made, particularly to the disclosure requirements that would assist the readers to better understand the future prospects of the company. For instance, analysts have indicated that they use certain other publicly available disclosures because they provide more meaningful disclosure than current U.S. GAAP. The IASB and FASB should work with the both the property and casualty insurance and health user community as well as the financial statement preparers to enhance the current GAAP disclosures.

For life insurance contracts, there are several areas of current U.S. GAAP that should be reconsidered, improved or eliminated. Currently, U.S. GAAP has extensive rules-based pronouncements (e.g., SOP 05-1 and SOP 03-1) that require a substantial effort by companies with very little benefit to the users of the financial statements. There are multiple accounting models in use today (e.g., FAS 60 and FAS 97), resulting in different measurement and presentation of revenue. Additionally, FAS 133 requires bifurcation of embedded derivatives at fair value that allows for inconsistent treatment of similar product features. It is our belief that the liability valuation should encompass the entire economics of the contract since the product features are integrated.

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

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As businesses become more global in nature, it is important that there exist a level playing field for all participants. Appropriate global standards for insurance accounting would enable analysts and investors to compare the financial statements of entities with similar products across the world. As evidenced by our response, we do not believe that it is possible to account for all insurance contracts under one model, since there are many different types of insurance contracts with significantly different features. The various types of insurance contracts should be thought of on a continuum with certain life-type products that exhibit some characteristics of investment contracts on one end and certain property and casualty and health contracts that are more analogous to service contracts at the other end. Any standard(s) should recognize the differences in insurance products along this continuum.

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, the preliminary views in the DP are not a suitable starting point for the following reasons:

- 1. It is based on the incorrect premise that all insurance contracts are economically similar to financial instruments.
- 2. The measurement objective described in the current exit value model in the DP is irrelevant and may be misleading to investors since the transfer in most instances can not happen due to regulatory constraints. Additionally, the model requires the use of hypothetical assumptions that can not be verified, and gives priority to such hypothetical assumptions when more relevant and reliable entity-specific information is available that more accurately reflects the characteristics of particular portfolios of contracts.
- 3. The paper does not reflect the most globally used and understood accounting method for property and casualty insurance contracts and many health contracts (i.e., FAS 60 under U.S. GAAP). While not perfect, there are many elements that provide relevant information and should be included in a new standard.
- 4. The preliminary views contain a significant amount of actuarial guidance. It is our belief that the insurance contract project should set the measurement objective(s) and allow the actuarial profession to determine how best to achieve the objective.
- 5. The DP uses arguments based on immateriality to get around certain aspects of the model that are conceptually inconsistent (e.g., symmetry of gross risk margins with risk margins on ceded reinsurance and recording gains at policy issuance). The principles should stand on their own without the need to resort to immateriality arguments.
- 6. Some of the views expressed are inconsistent within the paper. For instance, the DP stresses a current exit value model but attempts to limit the inclusion of premiums and dividends in the liability calculation which market participants would include in an economic valuation.
- 7. Some features which are substantially integrated into insurance contracts would be measured separately using different accounting standards that might be applied to deposit or service elements.

Although we do not believe that the preliminary views in the DP are a suitable starting point, the DP and the supporting information used by the IASB in their deliberation provide the Board with a significant amount of useful information. Additionally, current U.S. GAAP and the views expressed to the IASB by various trade organizations should be considered in deliberations.

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, the measurement objective which is accomplished through the building blocks is not feasible to implement reliably for U.S. property and casualty and health insurance contracts. In addition, for life insurance contracts, we believe that there are significant flaws in the IASB's preliminary views for each building block. Below is a summary of the issues with the building blocks.

Building Block 1:

We do not believe probability weighting all possible cash flows is both necessary and possible to implement. The significant uncertainty associated with some U.S. insurance liabilities makes it impossible to know "all" possible cash flows and to assign probability weights to a sufficient degree of reliability for financial statements. Additionally, in many instances less time-consuming actuarial methodologies can result in a similar liability valuation that is relevant and reliable. The proposed requirement would not improve the valuation of insurance liabilities, instead it would indicate to the reader a level of precision that does not exist. In addition, as noted above, we believe that the cash flows that are considered in the IASB Discussion Paper in determining the liability are artificially limited (e.g., for dividends and for future premiums) and would not reflect the actual cash flows from the contract. Additionally, many of the assumptions that would be used in determining cash flows would be dependent on hypothetical market factors that cannot be verified, when more relevant and reliable entity-specific information is available.

Development of a principles-based standard for all insurance contracts must consider the unique operation of medical insurance contracts in the United States to report relevant, reliable financial performance and condition for this business. In particular, the emphasis in the IASB's proposed model on the use of market participant data could improperly lead to the exclusion of entity-specific data when projecting cash flows for the liability measurement. The guidance on cash flow must be clarified so that certain entity-specific cash flows such as those related to provider networks, medical and disease management and claims payment systems unique to the United States private medical insurance market are included in the accounting model to provide for an accurate measurement and representation of the contract's settlement value.

Our final comment on this building block is that it would not be practical to perform on a quarterly basis. Determining the cash flows and assigning the appropriate probabilities would not be possible based on the current deadlines for completing SEC financial statement filings. Any final standard should allow for practical methods that achieve reliable and relevant results.

Building Block 2

We believe that there are several technical issues with this building block that need to be resolved prior to it becoming operational. For instance, the Discussion Paper does not discuss liabilities that depend directly on investment returns and appears not to contemplate liabilities with cash flows that extend past the duration of market observable funding instruments.

Building Block 3

The issues we have with this building block are due to the requirement to use a risk and service margin that market participants require for bearing insurance servicing and risk. In addition to

being irrelevant, it is impossible to verify that the appropriate margin was used since there is not a market to calibrate the margin.

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?

See our response to Question 1a.

Ouestion 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 are not aware of significant issues with the accounting by policyholders for insurance contracts and therefore believe that it should have a lower priority. Additionally, the accounting used by policyholders, particularly commercial enterprises, should be evaluated in the context of the policyholders' accounting, not the insurers' accounting.

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?

Due to the distinct economics of insurance contracts, it is important for some of the projects listed above to be deliberated in tandem in order to avoid setting a precedent in one project that would result in additional changes to insurance accounting and reporting in the future. We are concerned that if some of the projects are completed prior to the insurance contracts project, the Board will not have had the full benefit of a greater understanding of insurance contracts which could lead to guidance that does not appropriately reflect the economics of the various types of insurance contracts. Similarly, we would also find it suboptimal if the Board issued insurance guidance prior to completing the other projects and then re-opened the accounting for insurance contracts later, resulting in significant costs to insurers to analyze, respond to, and ultimately implement further additional guidance at that point.