

June 19, 2009

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1660-100

Dear Mr. Golden:

The National Association of Mutual Insurance Companies (NAMIC) is pleased to make comment on the Board's Discussion Paper "Preliminary Views on Revenue Recognition in Contracts with Customers (hereafter "Discussion Paper"). Our members' primary system for financial reporting is statutory accounting, as created and maintained by states and the NAIC, but it is well known that GAAP affects or becomes the substance of statutory accounting. For that reason, we choose here to make comment on the Discussion Paper and urge your consideration of our analyses and recommendations.

Although we agree with Board's stated objectives to (1) remove the inconsistencies and weaknesses in the existing standards, (2) simplify the preparation of the financial statements and (3) improve the comparability of revenue across companies, we do not agree that the guidance proposed in the Discussion Paper achieves these objectives for insurance contracts. In particular, the guidance does not achieve these objectives for insurance contracts that are within the scope of Statement of Financial Accounting Standard No. 60, *Accounting and Reporting by Insurance Enterprises*, (FAS 60). We believe that the Discussion Paper provides an appropriate basis from which to derive revenue recognition as it relates to insurance contracts but without significant clarifications around some of the more substantial principles of the guidance, the Discussion Paper will result in inconsistent application across the insurance industry.

We appreciate that the Discussion Paper recognizes that the proposed revenue recognition model, and in particular the measurement approach, may not provide decision-useful information for short-duration insurance contracts. As stated in section 5.89 of the Discussion Paper, "the outcome of an insurance contract can be highly variable because uncertainty is an inherent characteristic of insurance contracts." We agree with this statement and believe that the combination of management's determination of performance obligations, the application of the allocated transaction price approach and the remeasurement approach will lead to inconsistencies in practice and will not produce decision-useful information. Consequently, the guidance proposed in the Discussion Paper may cause additional confusion to the users of financial statements rather than simplifying the financial information due to the inconsistent application that is likely to occur across the industry. Accordingly, our recommendation is to either (1) provide clarification around the guidance related to what constitutes a performance obligation as it relates to insurance contracts, assess what the delivery of an asset or transfer of a service means for insurance contracts, and address how this guidance fits into the pooling-of-risks concept that is the basis for the insurance model or (2) remove

insurance contracts from the scope of the proposed general revenue recognition guidance. As such, we support development of industry-specific guidance as evaluated through the Board and IASB Insurance Contract Joint Project.

While we agree with the use of the transaction price or consideration promised as the basis for contract revenue, our concerns around the possibility for inconsistent application of other key aspects of the guidance are foremost among our concerns, since we believe there are significant features of insurance contracts not incorporated in the guidance. Some of these significant features are outlined below:

- The Discussion Paper derives the timing of revenue recognition from the transfer of assets or services to the customer. Clarification around how this principle can be applied to insurance contracts will be required in order to ensure consistent application across the insurance industry.
- What constitutes a performance obligation as it relates to insurance contracts additionally deserves added clarity. For example, the treatment of contingent liabilities may result in possible inclusion of the contingent liabilities in the performance obligations by some companies and exclusion from the performance obligations by other companies. This diversity in the interpretations will lead to drastic differences in the timing of revenue recognition.
- Under current insurance guidance companies can adjust their reserve estimates for both adverse and favorable development. The proposed guidance will allow a contract to be re-measured only when the contract is in a difficult position.
- The business of providing insurance was built on the concept of pooling-of-risks. The proposed guidance does not address this fundamental concept which provides companies with the ability to take on insurance risk. Rather the proposed guidance requires each customer contract to be assessed on a contract-by-contract basis.
- The Insurance Contract Joint Project is likely to remove the ability for insurance companies to defer certain acquisition costs. This change in guidance in combination with the proposed guidance which does not allow a company to earn day one income will cause a mismatch on the income statement. This mismatch will be amplified when applied to reinsurance arrangements.
- Taken at face value, the proposed guidance within the Discussion Paper may require unnecessary unbundling of performance obligations that will result in operational inefficiencies, further reporting inconsistencies and less useful information for the users of the financial information.

The Discussion Paper will lead to inconsistencies in practice as written because it does not frame the fundamental characteristics of insurance contracts. In addition, if the proposed revenue recognition model is embedded in the guidance adopted by the Insurance Contract Joint Project the outcome will be extremely problematic.

I. Significant Features of Insurance Contracts are not Incorporated in the Discussion Paper

The proposed guidance does not discuss elements of insurance contracts that, if not addressed, will lead to further removal from consistency across the industry. The Discussion Paper states that the revenue associated with each contract is equal to the transaction price. We agree that at the beginning of an insurance policy term, the performance obligation is equal to the contractual premium (transaction price) as this is the most observable and verifiable price available at the inception of the contract. The Discussion Paper goes on to state that the revenue is recognized when there is a change in the net contract position. This change occurs when performance obligations are satisfied. Obligations are satisfied when there is a transfer of the promised good or the contracted service takes place as indicated by the customer taking control of the asset or reaps the benefits of that service. Insurance companies provide risk coverage. The transfer of this service to the customer takes place *continuously throughout the policy term*, as such, revenue should be recognized proportionally over the policy term. Currently, the principles in the Discussion Paper could lead some insurance companies to believe they will be unable to recognize revenue until the expiration of the policy term and for this reason we believe it necessary to clarify when the service of providing risk coverage is deemed to have been transferred to the customer.

Another key feature of a company's accounting for an insurance contract is the contingent liability related to the estimate for future claim and claim adjustment expense for short-duration policies. The proposed guidance is vague as to whether or not this contingent obligation will be considered a true performance obligation. One company may conclude that the company's ultimate obligation is the coverage of risk during the policy term while another company may conclude that their obligation, while derived from the coverage provided, is more closely tied to the payment of the expected claims and claim adjustment expenses. This lack of clarity will lead to diversity in practice and an inability to compare financial information across the insurance industry.

The foundation of the concept of insurance is based on the pooling-of-risks concept. Insurance companies pool similar risks together in large populations to allow them to appropriately estimate their ultimate exposure. Assessing exposure on a contract-by-contract basis deviates from the very nature of insurance. If the exposure draft resulting from the Discussion Paper is written in a manner that includes the contingent obligation as a performance obligation and contract measurement is performed on a contract-by-contract basis, reserve estimates will be required to be performed on each contract individually. By assessing risk from the pooled approach, the ultimate contingent exposure can be appropriately assessed. Under the guidance proposed within the Discussion Paper there is a likely possibility that some insurance contracts will not be in an onerous position and therefore a contingent obligation will not be established until such time as an insured event occurs. Under these circumstances, the company's total reserves would be understated and the impact on the income statement would be erratic.

For individual contracts in a loss position, companies will be required to record adverse reserve development. Under current accounting guidance, insurance companies take adverse development when the book of business as a whole is not adequately reserved for; but, in contrast, if current reserve analysis demonstrates that the reserves are too conservative, an insurance company also has the ability to correct the estimate and record favorable development. The ability to adjust management estimates for both understatement and overstatement is appropriate, since errors in estimates can be faulty in either direction. Without the ability to account for corrections of an estimate for favorable developments, a company will likely be unable to reduce its reserve for each contract until many years following the expiration of a policy. The determination of the suitable time to make the adjustment may be completely subjective.

In addition, there are features such as mid-term cancellations that may lead to questionable timing of revenue recognition if the proposed guidance is applied to insurance contracts. For example, consider an insurance contract with two performance obligations, one related to the assurance provided and the second related to claims handling. The performance obligation related to providing assurance is recognized ratably over the policy term. The claims handling performance obligation is not considered complete until the expiration date of the policy. Under the revenue recognition model, a policy that is cancelled mid-term by the policyholder will result in a reduction of the performance obligation related to the assurance service offset by a cash refund to the customer as well as immediate recognition of revenue related to the claims handling services as there will be no additional instance that would require that obligation to be performed. Therefore, a company with a canceled policy can escalate its revenue recognition even though a performance obligation was not performed on the date of cancellation while a company that is providing service through the end of the contract will be required to delay recognition until the end of the policy term. We believe this example demonstrates how revenue recognition can deviate from the timing of when it is earned.

Another aspect of insurance contracts not fully treated within the Discussion Paper is the ability to continue to capitalize acquisition costs that are directly tied to the writing of insurance contracts. The Discussion Paper refers companies to existing guidance to determine the appropriateness of capitalizing costs. Therefore, under FAS 60, it appears that insurance companies will still have the ability to defer acquisition costs; however, there is other guidance on the horizon that is potentially relevant: In the Insurance Contracts Joint Project the ability to defer these costs may be eliminated. The inability to defer acquisition costs in conjunction with the proposed guidance in the Discussion Paper, which does not allow for day one income, will lead to day-one net losses for all insurance contracts. This treatment will create a mismatch in the income statement as revenue is deferred and the related expenses are recognized immediately. This accounting practice will impact the ability to compare profit margins across industries. This mismatch on the income statement will be compounded if the application of the proposed guidance is applied to reinsurance arrangements.

II. Application of the Proposed Guidance in the Discussion Paper will Lead to Inconsistencies in the Accounting for Insurance Contracts and Less Useful Information for the Users of the Financial Statements

The guidance proposed in the Discussion Paper will not lead to consistent application within the insurance industry, and therefore financial statements will not be comparable among insurance companies. Each company will be required to apply judgment to determine its respective performance obligations, as a result, companies will recognize revenue related to inconsistent performance obligations at various times, which circumstance will lead to a breakdown in comparability. In addition, the requirement to unbundle services is likely to cause unnecessary unbundling which will not benefit the users of the financial statements, since the unbundled services are not sold in the market individually. Even if management's judgments regarding the determination of performance obligations were consistent across the insurance industry, the allocation of the transaction price to each of the performance obligations will result in a breakdown in comparability across companies.

The Discussion Paper requires the transaction price to be allocated amongst the performance obligations based on each obligation's respective standalone selling value. When a stand-alone selling value is not available, which we believe will be the case for many insurance performance obligations, management

should use its best estimate. The inclusion of managerial judgment in the allocation method will lead to the application of inconsistent percentages of the overall transaction price allocated to each performance obligation. In turn, companies with the same performance obligations will recognize revenue differently over the same contract term which will obstruct the Board's stated objective by creating inconsistencies among issuers. Refer to Exhibit A for an example of the guidance proposed in the Discussion Paper to a simplified policy as interpreted by four different companies. The variations in the application of the accounting guidance as it relates to a very simple short duration policy example will be amplified when applied not only across the entire book of business but also to complex short duration policies.

As noted in the exhibit, each interpretation is within the lines of the guidance yet the revenue is recognized at different times by each of the companies. Due to the judgment involved in both the determination of a company's performance obligations as well as in the allocation of the transaction price, the prescriptions proposed in the Discussion Paper fall short of providing guidance that will lead to consistency, comparability, and simplicity in financial reporting and revenue recognition.

III. Continued need for a Separate Insurance Contract Joint Project and a Financial Instruments Joint Project

The Board and the IASB developed the joint projects to handle the complexities associated with the accounting for insurance contracts and financial instruments. The objectives under which the Insurance Contracts Joint Project was established include (1) improve and simplify the financial reporting requirements for insurance contracts, (2) eliminate the numerous pieces of current US GAAP accounting literature that add to the complexity of accounting, (3) provide investors with more decision useful information and (4) provide guidance that would aid in the consistency of accounting for insurance contracts across the industry. These objectives can not be met under the guidance proposed in the Discussion Paper as currently drafted based on the examples discussed above. As such, either (1) the Discussion Paper should be adjusted to clarify the guidance as it relates to the significant features of insurance contracts noted above, or (2) insurance contracts should be removed from the scope of the revenue recognition standard. The guidance, as proposed in the Discussion Paper, if applied to insurance contracts, will leave much to be interpreted and will inevitably lead to diversity in practice and the information provided to the users of the financial statements will be futile.

The objectives under which the Financial Instruments Joint Project was established included (1) the need to eliminate the more than 60 pieces of guidance that currently exist related to financial instruments, (2) provide more decision useful information to the users of the financial statements, (3) provide guidance that distinguishes between debt and equity, (4) reconsider the methodologies currently used for recognition and measurement of financial instruments, and (5) address issues related to impairments. These objectives will not be met under the guidance proposed in the Discussion Paper therefore financial instruments should be removed from the scope of the Discussion Paper.

CONCLUSION

While the guidance proposed in the Discussion Paper will a) remove the inconsistencies and weaknesses in the existing revenue recognition standards, b) simplify the preparation of the financial statements, and c) improve the comparability of revenue for most industries, it will not in its current formulation provide the

same benefits to the insurance industry. As such, we recommend that the Board and IASB clarify those problematic areas identified to preclude inconsistent application across the insurance industry or simply remove insurance contracts from the scope of the revenue recognition standard as proposed in the Discussion Paper by addressing these issues in the Insurance Contracts Joint Project. Because the Discussion Paper does not meet the objectives of the Financial Instruments Joint Project, we therefore recommend the removal of financial instruments from the scope of the Discussion Paper so that we may support the separate joint project related to financial instruments.

We hope these comments assist the Board during its re-deliberations of the Discussion Paper. In the event that any Board or FASB staff member would like any further clarification of our positions we are able to discuss them in greater detail.

Respectfully,

Accounting Committee
National Association of Mutual Insurance Companies

by William Boyd, CPA
Staff for Committee
(317) 875-5250
E-Mail bboyd@namic.org

Exhibit A: Short Duration Policy Example

Policy Terms:

- One-year homeowner’s policy
- Premium \$2,000, Due 1/1/09
- Acquisition Costs \$200
- Policy Effective Date 1/1/09

Step One - Define the Customer’s Rights and Company Performance Obligations

Step Two – Determine the net contract position

- Day One the net contract position is \$0
- As the customer pays the premium payment or the Company provides any of the services noted above the contract position will change

Step Three – Allocate the transaction price among the performance obligations

Step Four – Determine when the performance obligations will be satisfied in order to determine when revenue will be recognized

Step Five – Assess timing of revenue recognition

**Potential Variation in the Application of the Revenue Recognition Guidance
 (Example Interpretations by 4 Companies):**

Company A

Step One - Define the Customer’s Rights and Company Performance Obligations

- Consideration of \$2,000 is the Customer’s Rights
- The Company’s Performance Obligations include:
 - i. Service of providing economic protection (insurance protection)

Step Two – Determine the net contract position

- Day One the net contract position is \$0
- As the customer pays the premium payment or the Company provides any of the services noted above the contract position will change

Step Three – Allocate the transaction price among the performance obligations

- As there is only one performance obligation, the transaction price is 100% allocated to the service of providing economic protection

Step Four – Determine when the performance obligations will be satisfied in order to determine when revenue will be recognized

- Insurance Protection is provided during each day of the policy term, as there is no seasonal factors related to the policy, the revenue attributed to this performance obligation should be allocated to the 365 days of coverage (\$5.56 per day, \$167 per month)

Step Five –Assess timing of revenue recognition

	1/1/09	7/1/09	12/31/09
Cash	\$2,000		
Performance Obligations	\$2,000	(\$1,000)	(\$1,000)
Revenue		\$1,000	\$1,000

Note - “()” represents a decrease to the account

Company B

Step One - Define the Customer's Rights and Company Performance Obligations

- Consideration of \$2,000 is the Customer's Rights
- The Company's Performance Obligations include:
 - i. Service of providing economic protection (insurance protection)
 - ii. Claim handling/payment service

Step Two – Determine the net contract position

- Day One the net contract position is \$0
- As the customer pays the premium payment or the Company provides any of the services noted above the contract position will change

Step Three – Allocate the transaction price among the performance obligations

	Standalone Selling Price	Allocation of Transaction Price	Measurement of POs
Insurance Protection	\$1,900	90.5%	\$1,810
Claim Handling / Payment	\$200	9.5%	\$190
Total	\$2,100	100%	\$2,000

Step Four – Determine when the performance obligations will be satisfied in order to determine when revenue will be recognized

- Insurance Protection is provided during each day of the policy term, as there is no seasonal factors related to the policy, the revenue attributed to this performance obligation should be allocated to the 365 days of coverage (\$5.02 per day, \$150.80 per month)
- Claims Handling/Payment service is performed as necessary during the policy term and possibly after the policy term, due to the greater possibility that the claims will be paid before the end of the policy term with only a small percent after, the performance obligation will be considered 85% satisfied as of the expiration date and 15% six months after the expiration date (\$161.50 recognized at the end of the policy term, \$28.5 recognized six months after the policy term)

Step Five – Assess timing of revenue recognition

	1/1/09	7/1/09	12/31/09	7/1/10
Cash	\$2,000			
Performance Obligations	\$2,000	(\$905)	(\$1066.50)	(\$28.50)
Revenue		\$905	\$1,066.50	\$28.50

Note - “()” represents a decrease to the account

Company C

Step One - Define the Customer's Rights and Company Performance Obligations

- Consideration of \$2,000 is the Customer's Rights
- The Company's Performance Obligations include:
 - i. Service of providing economic protection (insurance protection)
 - ii. Claim handling/payment service

Step Two – Determine the net contract position

- Day One the net contract position is \$0
- As the customer pays the premium payment or the Company provides any of the services noted above the contract position will change

Step Three – Allocate the transaction price among the performance obligations

	Standalone Selling Price	Allocation of Transaction Price	Measurement of POs
Insurance Protection	\$2,000	97.6%	\$1,952
Claim Handling / Payment	\$50	2.4%	\$48
Total	\$2,050	100%	\$2,000

Step Four – Determine when the performance obligations will be satisfied in order to determine when revenue will be recognized

- Insurance Protection is provided during each day of the policy term, as there is no seasonal factors related to the policy, the revenue attributed to this performance obligation should be allocated to the 365 days of coverage (\$5.42 per day, \$162.67 per month)
- Claims Handling/Payment service is performed as necessary during the policy term and possibly after the policy term, due to the greater possibility that the claims will be paid before the end of the policy term with only a small percent after, the performance obligation will be considered 85% satisfied as of the expiration date and 15% six months after the expiration date (\$40.80 recognized at the end of the policy term, \$7.20 recognized six months after the policy term)

Step Five – Assess timing of revenue recognition

	1/1/09	7/1/09	12/31/09	7/1/10
Cash	\$2,000			
Performance Obligations	\$2,000	(\$976)	(\$1016.80)	(\$7.20)
Revenue		\$976	\$1,016.80	\$7.20

Note - “()” represents a decrease to the account

Company D

Step One - Define the Customer's Rights and Company Performance Obligations

- Consideration of \$2,000 is the Customer's Rights
- The Company's Performance Obligations include:
 - i. Service of providing economic protection (insurance protection)
 - ii. Claim handling/payment service

Step Two – Determine the net contract position

- Day One the net contract position is \$0
- As the customer pays the premium payment or the Company provides any of the services noted above the contract position will change

Step Three – Allocate the transaction price among the performance obligations

	Standalone Selling Price	Allocation of Transaction Price	Measurement of POs
Insurance Protection	\$1,900	90.5%	\$1,810
Claim Handling / Payment	\$200	9.5%	\$190
Total	\$2,100	100%	\$2,000

Step Four – Determine when the performance obligations will be satisfied in order to determine when revenue will be recognized

- Insurance Protection is provided throughout the policy term but the performance obligation is not viewed as fully performed until the day the policy term expires therefore the revenue related can not be earned until expiration date
- Claims Handling/Payment service is available during each day of the policy term, as there is no seasonal factors related to the policy, the revenue attributed to this performance obligation should be allocated to the 365 days of coverage (\$.52 per day, \$15.80 per month)

Step Five – Assess the timing of revenue recognition

	1/1/09	7/1/09	12/31/09
Cash	\$2,000		
Performance Obligations	\$2,000	(\$95)	(\$1,905)
Revenue		\$95	\$1,905

Note - “()” represents a decrease to the account

Side by Side Comparison of the Revenue Recognition Timing

	Co. A	Co. B	Co. C	Co. D
1/1/09				
Cash	\$2,000	\$2,000	\$2,000	\$2,000
Performance Obligations	\$2,000	\$2,000	\$2,000	\$2,000
7/1/09				
Revenue	\$1,000	\$905	\$976	\$95
12/31/09				
Revenue	\$1,000	\$1,066.50	\$1,016.80	\$1,905
7/1/10				
Revenue	\$0	\$28.50	\$7.20	\$0