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Ms. Leslie Siedman Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: FASB Discussion Paper, Preliminary Views on Insurance Contracts

File Reference No. 1870-100

Dear Leslie:

The Travelers Companies, Inc. (Travelers) appreciates the opportunity to comment on the Financial Accounting Standards Board's (the FASB or the "Board") Discussion Paper (DP), *Preliminary Views on Insurance Contracts*. Additionally, we are very appreciative of the Board's approach and commitment to the project, including the actions taken to secure knowledgeable, technical staffing to complete the project.

Travelers is a leading provider of property and casualty (P&C) insurance products and services to a wide variety of businesses and organizations as well as to individuals. Our products are distributed primarily through independent insurance agents and brokers throughout the United States (U.S.) and in selected international markets. As a provider of P&C contracts, our comments will focus on the accounting treatment for these types of contracts and not on life and health insurance contracts.

As we have submitted detailed comments to the IASB on their Exposure Draft (ED), *Insurance Contracts* (Attachment 1), we will focus our comments on the questions raised by the Board in the DP, specifically whether the IASB proposal would be an improvement on current generally accepted accounting principles in the U.S. (U.S. GAAP) and if current U.S. GAAP could use a comprehensive reconsideration or some targeted improvements. We will also comment on several tentative decisions that are in the DP as well as some of the Board members' indications of preference that were made during deliberations.

We believe that the questions the Board asked in the DP are pertinent and that issuing a DP is the appropriate means for seeking input as the IASB/FASB deliberations have not advanced to a sufficient level to issue an exposure draft.

### Is the IASB ED an Improvement to Current U.S. GAAP?

In following the development of the ED, it appeared that the IASB maintained a greater focus on life insurance contracts, without fully deliberating the differences between life, P&C, and other types of insurance contracts. Accordingly, the proposed accounting model set forth in the ED appears to have been developed for life insurance products and then (wholly or partially) applied to P&C products. As a result, there was not sufficient consideration of the many differences among the various types of

insurance coverages and contracts and, in particular, the different drivers of product profitability between life and P&C products.

While the primary driver of profitability for life insurance products is generally capital markets driven (i.e., investment returns less amounts credited to policyholders), the primary driver of product profitability for P&C products is driven by the loss cost component of underwriting results (i.e., premiums less claims costs and expenses) and investment income is a secondary consideration. We believe the accounting model(s) should reflect this difference between capital markets driven products and loss driven products.

Accordingly, we do not believe that the proposed accounting guidance in the IASB ED as currently drafted would represent an improvement over current U.S. GAAP for P&C insurance contracts. We found certain aspects of the ED to be difficult to evaluate and believe that additional deliberations are needed in certain areas, including specific issues related to P&C contracts (including reinsurance), before a final standard is issued. Additionally, we concluded that we could not implement the ED as drafted due to several issues that remain regarding the proposed guidance. In particular, we believe that additional work is needed in the following areas:

- The timing of recognition of a P&C insurance contract in the financial statements;
- The criteria for distinguishing between contracts that should be accounted for using the building block approach and the modified approach (premium allocation method);
- The measurement of expected future cash flows;
- Whether and how to discount for the time value of money for both the pre-claim and claim liability; and
- Certain elements of the presentation and disclosure guidance.

Based on what we believe to be the IASB's intent in the ED, we do not believe that many of the proposed concepts would produce information for users that is more meaningful than what is currently provided under U.S. GAAP. Some of our main concerns with the accounting model described in the ED are as follows:

- ✓ The recognition of amounts related to an insurance contract at the "bound date" would result in costly systems (and compliance) changes while providing little or no benefit to users of the financial statements.
- ✓ The criteria for requiring the use of the premium allocation method is arbitrary. For P&C insurers, similar contracts that differ only as to coverage period would be accounted for using two different models.
- ✓ The premium allocation method as set for in the ED is overly burdensome for a simplified model. Requiring the discounting of future premiums, the accretion of interest on the discount, and an onerous contract test would increase the cost of accounting for insurance contracts without improving the usefulness of the reported information related to insurance contracts. We believe the current U.S. GAAP guidance for the unearned premium reserve method and the premium deficiency test are simpler to apply, produce results that are not conceptually dissimilar to the model in the ED, and should be retained.
- ✓ For the claims liability, the requirement to probability-weight cash flows is not practical and is inconsistent with currently available actuarial methods.

- ✓ The risk adjustment is not reliably measurable for many P&C claim liabilities.
- ✓ P&C claims liabilities should be discounted only when the amount and timing of claim payments are fixed or reliably determinable and the discount provides relevant (i.e., the amount of discount is material) information to the users of the financial statements.
- ✓ The proposed model would remove many of the current metrics used to measure product profitability and would result in the increased use of non-GAAP financial measures in SEC filings to convey the results of P&C business to users of the financial statements.

# Comprehensive Reconsideration or Targeted Improvements to U.S. GAAP

We believe that the Board should at most consider targeted improvements to U.S. GAAP and not a comprehensive reconsideration. U.S. GAAP for P&C contracts is well established and has been used globally without posing significant issues with regard to application, auditing, and analysis. Generally, users understand the accounting and reporting for P&C contracts and the information (including performance metrics) that is reported to users is consistent with how management reviews performance of the business. Additionally, the uncertainty regarding the estimation of the claims liability is well understood with significant disclosure regarding the risks and uncertainties in the Critical Accounting Estimates of the Managements Discussion and Analysis section of Form 10-K of Securities and Exchange Commission filers.

### **Comments of Certain FASB Tentative Decisions and Indications**

As discussed above and in the attached comment letter to the IASB, we have significant concerns with the ED. We also have concerns with several of the FASB's differing tentative decisions if applied to P&C contracts as well as some of the Board's indications regarding short duration contracts. Our concerns are with respect to the composite margin, deferred acquisition costs, and requiring different accounting for short duration contracts based on the potential duration of the *settlement* period (resulting in two models for short duration contracts).

#### Composite Margin

We note that the Board has not concluded on whether P&C insurance contracts should have a different accounting model than life and other insurance contracts, and which types of contracts would be included in a different model, if applicable. We believe the Board should retain the current two model system; however, if there is not a separate accounting model for P&C contracts, it is important to note that the composite margin is not conceptually appropriate or operational for P&C contracts. The composite margin approach:

- ✓ Assumes that the same risks exist during the pre- and post claims periods. This assumption is not accurate for P&C contracts since the significant variable during the pre-claims period is event risk (i.e., the risk an insured event occurs) while settlement risk (e.g., litigation and negotiation) is most significant during the post-claims period.
- ✓ Does not recognize that P&C insurers do not manage claims liabilities on the same basis as premiums are recognized. Claims liabilities are evaluated based on the type of risk and not on a portfolio of contracts, which contain multiple types of risk (e.g., auto and homeowners have both

property damage and general liability exposure). Premiums are recognized on a portfolio basis for all types of risks.

✓ Would result in the deferred recognition of the portion of premium charged to cover overhead and similar charges. The overhead and other charges would continue to be incurred during the coverage period, and deferring the revenue would create a disjoint with the between the revenue and expense recognition.

For P&C contracts, we believe that the revenue should be recognized over the coverage period (i.e., the period over which insurers provide the service of coverage) with any related claims liability (as appropriate) recorded to capture what is expected to be paid. Conceptually, this matches revenue with the expected losses from the contracts in the period of coverage. After the coverage period, the insurer should adjust the claims liability as new information about the claims is received with changes in the expected amount recorded in the statement of income.

#### Deferred Acquisition Costs

Since P&C contracts have short coverage periods, a simplified approach to accounting for deferred acquisition costs is the most cost effective. It would be costly for P&C insurers to create systems to track non-incremental costs and defer those costs based on a successful efforts notion when the costs would then be amortized in most cases over one year or less. For this reason, we agree with the IASB that only incremental acquisition costs should be deferred for P&C contracts. This is consistent with our accounting policy and was maintained in ASU No. 2010-26 Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (ASU 2010-26). We note, however, that this accounting was included in the transition provisions of ASU 2010-26 and not the guidance itself. We recommend that if the Board carries over the provisions of ASU 2010-26 into a new insurance accounting standard, that the transition provision be carried forward as well.

#### Two Models for Short Duration Contracts

We understand that the Board is considering not only whether there should be different models for long and short duration contracts, but also whether there should be two models for short duration contracts based on the length of the potential settlement periods. We are concerned with the potential of having to apply two different accounting models to short duration contracts based on the expected settlement period for the following reasons:

- Many P&C insurance contracts contain multiple coverages that have different potential settlement
  periods and it would be costly to insurers and confusing to users to use two measurement accounting
  models for different coverages under a single contract. For example, auto and homeowners policies
  have both liability and physical loss components with the liability coverage generally settled over a
  longer time period.
- It is not known with certainty by insurers whether claims under various types of exposures will be settled quickly or take longer than what has been observed in the past. There are many instances where claims that generally settle quickly take significant longer and vice versa. For instance, homeowners policies (physical damage coverage) generally are settled quickly, but the settlement period could be substantially longer after a hurricane (e.g., coverage disputes over flood or wind) or earthquake (i.e., cracks in basements might not be attributed to the earthquake for years after event).

Conversely, a liability claim, which generally takes longer to settle, may be paid out very quickly if the insurer knows the policyholder is legally at fault and the damages are easy to determine.

• Certain P&C policies are priced as a complete package (e.g., commercial multi-peril) and it would be difficult, and not particularly meaningful, to deconstruct the price for each exposure to separate the accounting of the contract into two models.

## Other Targeted Changes to US GAAP

We believe that the FASB should take a targeted approach to improving U.S. GAAP and consider addressing the following areas:

- Conforming the definition of insurance with ED,
- Putting a focus on the contract instead of the writer of the contract, and
- Providing guidance for the discounting of P&C claims liabilities when claims payments are fixed or reliably determinable.

While the scope of these changes would be limited, we believe that they would improve comparability of the reporting of similar types of insurance contracts.

### Conclusion

We do not believe that the guidance in the IASB ED as currently draft represents an improvement over current U.S. GAAP. We are concerned that the proposed guidance would make it more difficult to convey product profitability to users of the financial statements and would increase the use of non-GAAP financial measures in P&C insurers' SEC filings. We encourage the FASB to take a targeted approach to improving U.S. GAAP.

We would be very pleased to discuss our views with the Board's at your convenience. Please feel free to call me if you have any questions or would like to discuss our comments further.

Sincerely,

D. Keith Bell

with Bell

cc: Jay Benet