

November 6, 2013

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2013-290 Proposed Accounting Standards Update—Insurance Contracts (Topic 834)

Dear Ms. Cosper:

McGladrey LLP appreciates the opportunity to comment on the proposed Accounting Standards Update (ASU), *Insurance Contracts (Topic 834)* (the proposed ASU). McGladrey is the leading provider of professional services to the middle market, including middle market insurers that provide insurance products to businesses and individuals across the country.

We appreciate the efforts of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) to develop a converged standard on accounting for insurance contracts. While the Boards have made tremendous progress, it is unclear to us whether a converged standard is an achievable goal at this juncture. If the Boards are unable to arrive at a widely-accepted and thoroughly-tested converged standard, we do not believe the FASB should make wholesale changes to the current accounting model for insurance entities in U.S. generally accepted accounting principles (GAAP). While not perfect, the current accounting model is well-established and well-understood by preparers, users, auditors, regulators and other financial reporting stakeholders. If the FASB is faced with the choice of (a) replacing the current accounting model with an entirely new model that is not converged with International Financial Reporting Standards (IFRS) or (b) retaining the current accounting model and making targeted improvements to it, we would strongly support the latter approach. We believe wholesale changes to accounting for insurance contracts under U.S. GAAP would only be warranted if those wholesale changes result in a widely-accepted and thoroughly-tested converged standard.

With respect to the accounting model in the proposed ASU, it is not clear that the benefits of implementing that model would outweigh the costs of doing so. In addition, we are not supportive of expanding the scope of insurance accounting to non-insurers (e.g., banks) that enter into contingently fundable credit transactions that would be considered insurance contracts (as defined in the proposed ASU). We discuss these and other issues with the proposed ASU as well as our recommendation on an effective date in the remainder of this letter.

Costs vs. benefits

We believe the proposed ASU would introduce an extraordinary amount of measurement complexity to the accounting for insurance contracts. At significant cost to insurers, new information gathering methods and measurement models would have to be put into place to implement the proposed ASU. Given the

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limited financial reporting resources that small- and medium-sized insurers have in comparison to large insurers, the relative cost burden to the small- and medium-sized insurers would be much greater. The costs associated with implementing the proposed ASU would not be limited to just insurers. While insurers would incur significant training costs, so too would analysts, auditors and regulators.

We are not convinced that implementing the guidance in the proposed ASU would result in an overall improvement in the nature of the information provided to users of insurers' financial statements. We believe the measurements that would be required by the proposed ASU are disconnected from the business model of insurers. We also believe that redefining the widely understood concept of earned premium to be the sum of expected claims and benefits plus the release of margin would not necessarily result in more reliable, verifiable and timely data from a decision-making perspective. We understand that estimation uncertainty is an accepted part of many operational accounting models. However, we question whether the level of estimation uncertainty involved in certain aspects of the accounting model in the proposed ASU renders the outputs of the accounting model unreliable. In addition, we believe users of an insurer's financial statements understand revenues to be a function of sales and pricing (not the duration of liabilities) and profit to be the overall difference in cash inflows and outflows related to a contract. We do not understand how the proposed ASU's change to make profit a release of risk from changes in the variability of cash flows produces more decision-useful information for either the preparers or users of the financial statements. While buy- and sell-side analysts may find some value in the derived outputs of the proposed ASU's accounting model, we believe typical investors and other financial statement users may find those outputs and the model used to derive them very difficult to understand and lacking in value from a decision-usefulness perspective.

Knowing there would be significant costs related to the implementation of the proposed ASU without having a clear understanding of the benefits of doing so results in a cost vs. benefit analysis that is not supportive of the proposed ASU. We recommend that the FASB perform additional outreach and field tests to determine whether the benefits of implementing the proposed ASU would truly outweigh the implementation costs. When doing so, we recommend the FASB solicit input from small- to medium-sized insurers and the users of their financial statements.

Expanding the scope to non-insurers

We have concerns about the scope of the proposed ASU and, indirectly, the definitions of insurance contract, insurance risk and financial risk included in the proposed ASU, which would result in entities not typically thought of as insurers having to apply the guidance in the proposed ASU. For the following reasons, we believe the scope of the proposed ASU and (or) definition of an insurance contract should be reconsidered so that non-insurers (e.g., banks and other financial institutions) would not have to account for certain products as insurance contracts:

- *Bringing consistency to the accounting for insurance contracts may bring inconsistency elsewhere.* We understand the FASB's desire to have consistent accounting for contracts of a similar nature regardless of the type of entity that issues the contracts. However, bringing consistency to the accounting of almost all contracts that meet the definition of an insurance contract could create inconsistencies in other ways. For example, as written, the proposed ASU would scope in certain commonly available bank products, such as financial guarantees and standby letters of credit. These are basic credit products commonly offered by banks and other financial institutions. If a payment is made, rather than triggering a loss to the financial institution, it generally results in the recognition of a loan. In many cases, these loans are supported by collateral. To require banks and other financial institutions to account for these basic products using insurance accounting would create

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inconsistencies in their financial statements given that such instruments would no longer be subject to the same credit impairment model as other credit-related products offered by these entities.

- *Credit risk should be taken into consideration in determining whether a contract is an insurance contract.* Products such as financial guarantees and standby letters of credit have a distinct characteristic that makes them fundamentally different from a typical insurance contract – credit risk. In fact, whether or not a loss is incurred by the issuing institution is generally heavily dependent upon the creditworthiness of the institution's customer as opposed to the mere occurrence of the triggering event. We believe the preponderance of credit risk in bank products, such as financial guarantees and standby letters of credit, warrants an exclusion of such contracts from the scope of the proposed ASU or from the definition of insurance contracts.
- *Inconsistent treatment related to guarantees of trust preferred securities.* We do not believe that guarantees issued by financial institutions for the repayment of trust preferred securities should be considered insurance contracts when the financial institution owns 100% of the trust that issued the securities. In our view, this is in substance no different than a guarantee of an entity's own performance, which would not be considered an insurance contract under the proposed ASU.
- *Standard representations and warranties on sold or securitized assets.* The table included in paragraph 834-10-55-40 of the proposed ASU considers whole loan sale guarantees and guarantees on securitized assets to be insurance contracts within the scope of the proposed ASU. It is not clear in the circumstances described if the entity providing the representations and warranties is the same entity that originated and sold or securitized the assets (hereafter referred to as the transferor). We do not believe it would be appropriate to consider representations and warranties on the part of the transferor to be insurance contracts as the representations and warranties relate to obligations of the transferor to fulfill its responsibilities. We therefore recommend that the examples in the table be clarified to indicate that the entity providing the representations and warranties is not the transferor of the assets.
- *Undefined benefits of using the insurance accounting model vs. the currently applicable GAAP accounting model.* It is not clear to us whether the users of non-insurers' financial statements would benefit from the application of an insurance accounting model to contracts that meet the definition of an insurance contract in the proposed ASU. In other words, it is not clear that applying the insurance accounting model in the proposed ASU to contracts such as financial guarantees and standby letters of credit would provide more decision-useful information to the users of banks' and other financial institutions' financial statements than the currently applicable GAAP accounting model. In addition, in the future, the difference between the two accounting models may be reduced given that expected discounted cash flows are an integral part of both the accounting model in the proposed ASU and the accounting model in the FASB's credit impairment loss proposal. We suggest additional outreach be performed to gauge whether users of non-insurers' financial statements believe there would be a substantive benefit to having non-insurers apply the insurance accounting model to credit-based contracts meeting the definition of an insurance contract in the proposed ASU.

Other issues

To the extent the FASB continues to work towards the development of a widely-accepted and thoroughly-tested converged standard on insurance contracts, we have identified the following additional points related to the proposed ASU for further consideration:

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- *Changes in the discount rate.* Under the proposed ASU, the effects of changes in the fulfillment cash flows attributable to changes in discount rates would be reflected in other comprehensive income (OCI). While we understand the basis for reflecting the effects of these changes in OCI, we also believe a legitimate case could be made to reflect these changes in the income statement if doing so would reduce an accounting presentation inconsistency between the asset side of the balance sheet and the liability side. For that reason, we believe insurers should be able to make a portfolio-by-portfolio election to reflect the effects of changes in the discount rate in either net income or OCI.
- *Discount rates for long-duration contracts.* It is not uncommon for insurance contracts to span long periods of time. Identifying an appropriate discount rate to use under the proposed ASU when dealing with long-duration contracts would be challenging given the lack of comparable market information publicly available. The verifiability of the discount rate (or lack thereof) would also be problematic for users and auditors of the financial statements. We believe additional guidance and parameters should be provided by the FASB related to the determination of the discount rate for long-duration contracts to alleviate the incremental lack of comparability and verifiability that may result absent such guidance.
- *Presentation of investment income.* The proposed ASU would result in presenting investment income after what are essentially the operating revenues and expenses of an insurer. Given the relative importance of investment income to the successful implementation of an insurer's business model, we believe investment income should continue to be presented as a core part of an insurer's revenue on the face of the income statement.
- *Recognition of a loss in the accounting for a business combination.* The proposed ASU would result in the recognition of a loss in the accounting for a business combination to the extent the fair value of the assets and liabilities related to insurance contracts were less than the amounts of those assets and liabilities measured in accordance with the proposed ASU. We do not believe it would be appropriate to recognize a loss in this situation as doing so would run contrary to the fundamental principles of the accounting model used to account for business combinations under U.S. GAAP.

Effective date

If the FASB moves forward with a comprehensive standard on accounting for insurance contracts, we believe an extended implementation period would be appropriate. Consistent with the approach the FASB has taken with the effective date for other projects with far-reaching consequences, we believe a minimum of three years should be provided for implementation. In addition, we believe an additional year should be provided for implementation by private insurers.

We appreciate the opportunity to provide feedback on the proposed ASU and would be pleased to respond to any questions the FASB or its staff may have concerning our comments. Please direct any questions to Jim Greisch (402.344.6104) or Rick Day (563.888.4017).

Sincerely,



McGladrey LLP