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Financial Accounting Standards Board  
Technical Director – File Reference No. 1325-100  
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LETTER OF COMMENT NO. 51

Dear Technical Director:

We appreciate the opportunity to respond to FASB's Invitation to Comment (ITC), *Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting*. CIGNA Corporation is a publicly traded company whose subsidiaries provide health care and related insurance benefits offered through the workplace. Our key insurance product lines include group medical coverages and related specialty health care products such as pharmacy, behavioral health and dental benefits as well as group disability, life and accident insurance. In addition, CIGNA has an international operation that offers products (that are generally similar to those offered domestically) to businesses and individuals in selected markets.

While the ITC presents bifurcation as a practical solution that could eliminate abuse of the current accounting model, we believe it is an overreaction that would introduce significant cost, less reliable estimation, inconsistency and unnecessary complexity into the financial statement preparation process of insurers for little to no benefit. Based on our read of news reports covering recent risk-related scandals, there were significant questions raised as to whether *existing* guidance was properly applied in those instances. We suggest the Board refrain from trying to fix what does not seem to be broken. Instead we suggest FASB conduct a more detailed study into the specifics of "what went wrong" in the cases of recent restatements due to accounting for insurance or reinsurance arrangements. If misapplication of existing guidance resulted from poor judgment or overlooked facts, we believe moving forward with this project is unnecessary and not cost justified. If misapplication resulted from a misinterpretation of literature in the context of what qualifies as "significant insurance risk" (and misinterpretation is considered to be pervasive) we would broadly support a limited clarification effort and further would be happy to serve as a resource for FASB on this topic. Our specific comments on the ITC are provided below for your consideration.

Issue 1: Does the IFRS 4 definition of insurance contract identify insurance contracts and sufficiently distinguish those contracts from other financial contracts? Does the GAAP definition of insurance risk identify and separate that risk from other risks such as financial risk? Do the descriptions of finite insurance and reinsurance contracts, including those with risk-limiting features identify those contracts? How could the definitions and descriptions be improved?

We believe that the definition of an insurance contract should reflect that transferred insurance risk is linked to either the policyholder or third party beneficiaries. This is true in the case of a group insurance contract where the parties to the contractual arrangement include the listed policyholder (or employer/sponsor) and the covered individual (employee, spouse or dependent.) The importance of this distinction will be relevant in our discussion of Issue 5 where we stress that group insurance contracts should not be viewed and accounted for differently from individual contracts merely because of their size.

We are comfortable with the definition of *insurance risk* as proposed and believe it is consistent with current understanding.

In addition, we agree with the ITC description of "finite" insurance/reinsurance, including the related list of loss-limiting contract features. However, we do not believe this description should be added to authoritative literature. Existing guidance clearly defines, in a principles-based manner, the elements of risk transfer that are required to permit insurance/reinsurance accounting. Further, including a list of possible risk-limiting features in a standard is likely to become less relevant as features change and emerge. Finally, it is important to note that it is possible for contracts with certain loss-limiting features such as retrospective rating to clearly demonstrate risk of loss sufficient to warrant insurance accounting. For example, the nature of CIGNA's retrospectively experience-rated business provides that a customer can terminate their contract with CIGNA even if they are in a deficit position. An account is considered to be in deficit when the medical costs and administrative charges, including profit charges, exceed the premium received. We believe this example clearly demonstrates there can be significant risk of loss on contracts considered to be "loss-limiting."

Issue 2: Can the Statement 113 risk transfer guidance for reinsurance contracts be applied by corporate policyholders and insurers for determining whether an insurance contract transfers significant insurance risk? If not, how can the Statement 113 guidance be modified or clarified to apply to insurance contracts?

We believe that current guidance provided in SFAS 113 could be applied to insurance contracts and is sufficient as written.

Issue 3: Does classifying an entire contract as insurance or bifurcating that contract into insurance and deposit components provide more understandable and decision-useful information? Which qualitative characteristics most influence your decision? Which approach more faithfully represents the economic substance of the transaction? Why?

Bifurcating contracts will *not* result in more understandable and decision-useful information. Imposing such a model on insurance/reinsurance contracts would require companies to go to extraordinary lengths to break integrated contracts into artificial, unnatural components that are not likely to be a better representation of economics and could be simply unreliable. We believe there is a natural interrelationship among all elements of a SFAS 60 or SFAS 113 contract, bound together by insurance risk. We believe this is evidenced in how underwriters and pricing actuaries evaluate and price business. Trying to discretely separate elements of an integrated contract could distort the financial position of a company and impact the ability of others such as regulators and investors to assess profitability, growth, pricing trends and capital adequacy.

We believe support for our view is evidenced in theory in at least two places in current authoritative literature. First, FASB Technical Bulletin (FTB) No. 85-4, *Accounting for Purchases of Life Insurance* (par. 5-7) recognizes the interrelationship of all elements of an insurance contract. The referenced paragraphs suggest that premium paid to a life insurance company serves *many purposes* ranging from payment for the assumption of mortality risk and insurer cost recovery, to the accumulation of contract value. It further indicates that while various attributes of a policy could be obtained separately (referring to investment and insurance elements), the combination of benefits and contract values could not typically be acquired without the insurance contract. We believe this language supports our view that the elements of an insurance contract are interrelated and can/should not be separated.

Second, we point to Statement of Financial Accounting Standards (SFAS) No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*. This Standard considered deposit accounting for a new product that contained insurance and investment elements, universal life-type contracts. Universal life contracts were specifically identified for deposit-type or bifurcated accounting because they were a new product with features that differed from traditional insurance contracts. The most distinguishing feature was that these contracts contained an explicit and contractual investment element – an accumulating account value. We believe the insurance and reinsurance contracts covered by SFAS 60 and SFAS 113 today do not have a similar explicit investment element and therefore do not warrant deposit accounting.

The Background and Conclusions section of this standard also indicates that at the time SFAS 97 was developed, bifurcation/deposit type accounting was considered as related to other types of participating or non-guaranteed contracts. It was determined by the Board that such contracts were to be excluded from scope because their form justified this exclusion (par. 48). FASB explained this difference by stating, “The operation of a universal life contract usually centers on an account or policy balance that is credited with interest and against which amounts are assessed for contract services. Participating and non-guaranteed-premium contracts usually lack this feature.” (par. 45) We believe bifurcation should not be applied to insurance contracts that do not specifically yield an account value such as is described in SFAS 97.

Finally, from a practical standpoint it has largely been acknowledged that current accounting standards contain an undue amount of complexity. The FASB has argued that accounting complexity reflects product or transactional complexity. However, artificially separating contractually integrated products seems to create complexity rather than report that which is inherent in the products. Consider recent FASB activities: issued earlier this year, Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Certain Hybrid Financial Instruments*, enables companies to fair value an entire instrument containing an embedded derivative versus requiring bifurcation of the derivative from its host contract – a movement in the direction of simplification. As previously discussed, bifurcation of insurance contracts would require that companies use judgment and estimation to separate a contract into unnatural elements that are not likely to be representative of the economics of the transaction. We believe this would be highly complex and overburdening, a direct contradiction to the stated goal of “simplicity.” In addition, in a recent speech to a conference of the American Institute of Certified Public Accountants, Bob Herz acknowledged the complexity of the rules and indicated that among the contributing factors were outdated rules-based legacy accounting standards, the continuing focus on short-term results in earnings reports, and *anti-abuse rules that were designed to curb the use of accounting “illusions” to boost financial results*. As indicated in our introductory paragraph we

encourage FASB not to add more complexity to the rulebook in reaction to misapplication of basic principles by a few.

Issue 4: The flowchart suggests a sequence for analyzing contracts that integrates current insurance accounting guidance with a hypothetical bifurcation analysis. Do you believe the sequencing and integration are appropriate? What changes would you propose?

As indicated previously, we believe the current framework for evaluating risk transfer is sufficient. We believe references to bifurcation, screens and “unequivocally transferred risk” should be removed. If the SFAS 113 risk transfer test is to apply to all contracts it should be moved beneath the inquiry as to whether a contract contains an embedded derivative. If a contract meets the definition of insurance/reinsurance, does not contain an embedded derivative (or that derivative has been bifurcated), and the contract adequately transfers risk under SFAS 113 it should be accounted for as insurance/reinsurance.

Issue 5: Do you agree with the characteristics identified for contracts that do or do not unequivocally transfer significant insurance risk? If not, why not? Should other characteristics be added? Are the examples in Appendix B representative of the discussion in paragraph 57-59?

If FASB proceeds with developing guidance for bifurcating insurance/reinsurance contracts, we believe the position on group contracts must be reconsidered. The ITC indicated that group contracts could not be considered to unequivocally transfer risk because they contain an implicit financing element. This element is said to result from the fact some degree of claim activity is expected from the outset of the contract and thus there is a level of expected return to the policyholder. We believe it would be inappropriate to differentiate between group and individual contracts on this basis because in substance both are transferring the same risk (underwriting and timing risk associated with claims). While we agree that for large employers with group coverage there is a reasonable range of expected losses that could occur in a given year, there is no certainty as to the nature of the event that would trigger a loss or its timing or severity. If there were certainty one would expect all of an insurer's group contracts to be profitable which has not been our experience. Furthermore, we believe that a certain amount of expected losses are factored into the pricing of all contracts, including individual contracts, where pricing may be based on pooled experience. Different accounting for policies of different sizes seems to clearly contradict the ‘principles-based’ approach. We believe similar contracts should be treated similarly and group and individual contracts are similar in substance.

In addition to the above mentioned theoretical concerns, we believe using the size of a contract as a screening technique for bifurcation would create significant practical application issues that would impair the comparability and usefulness of financial information. Of note, one could question at what level group experience would be considered “credible enough” to accurately measure expected losses (defined as the financing element of a contract). Further, if a company has group contracts of various sizes (some of which were considered credible and others of which were not) would it be appropriate to account for those contracts differently? Also, even if the financing element of a group contract were to be extracted based on predictive loss ranges, there will undoubtedly be substantial account by account variance in subsequent periods. How would this factor into the reporting model? If contracts were reclassified between an insurance or bifurcated accounting model based on actual results, financial reporting would be increasingly difficult to understand. And if contracts were not reclassified based on results, financial reporting of the risk and financing elements of contracts would be distorted.

Finally, we also believe from a data availability perspective it would be difficult for insurance companies to split reserves such as IBNR that are usually built at a pooled vs. policy level. Similarly, we believe corporate policyholders would struggle with a bifurcation requirement given that currently most do not have the infrastructure or expertise to support this accounting. In addition, given that today insurance-related costs are typically immaterial to a corporate policyholder we believe this additional burden would create significant additional cost for very little benefit.

Issue 6: Do you think the characteristics described in paragraph 58 for unequivocal insurance contracts are an improvement over the exemption from cash flow testing in paragraph 11 of SFAS 113 of this Invitation to comment?

No, please see response to Issue 5. Unequivocal testing introduces a “size-based” screening technique that we believe is inappropriate and would raise significant practical application issues.

Issue 7: Do you prefer Approach A or B for identifying contracts subject to bifurcation? Why? Do you believe that another approach would be superior? If so, how would you describe that approach? Would your preferred approach be operational? Would it make financial statements more decision useful?

We do not support bifurcation for any contracts that transfer significant insurance risk for the reasons provided above. However, if FASB proceeds to require bifurcation we would prefer the *narrowed* application outlined in Approach A. This preference reflects our desire to minimize the effects of an approach we believe is likely to be costly, less reliable, and unnecessarily complex. That said, it is important that FASB recognize that contracts with certain loss limiting features can exhibit significant risk of loss as we highlighted in our response to Issue 1. See Issue 3 for a discussion on why we feel bifurcation will not result in decision useful information.

Issue 8: Should the criteria for bifurcation be different for insurance contracts and reinsurance contracts? Why? If yes, what differences would you suggest?

We do not support bifurcation for either insurance or reinsurance contracts when the elements of these contracts are integrally linked. Any attempt to bifurcate a contract would be based on significant judgment and yield artificial results that are inherently flawed. However, if bifurcation were to be required, in the interest of simplification we believe the criteria should be the same for insurance and reinsurance contracts.

Issue 9: Which of the methods identified in this ITC for bifurcating insurance and reinsurance contracts do you believe has the most conceptual merit? Please explain. Please describe any additional bifurcation methods that you believe should be considered. Would corporate policyholders encounter unique implementation problems in applying any of the methods discussed in the ITC?

We do not believe that the concept of bifurcation has merit as related to insurance/reinsurance contracts. Therefore we do not believe any method described would adequately and reliably be able to capture “separate elements” of an integrated insurance/reinsurance contract. Further, as noted in our response to Issue 5, we believe there would be significant implementation problems associated with all noted bifurcation approaches for both insurance companies and corporate

policyholders that would generate significant incremental cost. If FASB were to proceed to require bifurcation of certain contracts, we would support a model that required deposit accounting for only those cash flows that explicitly and unequivocally *must* be returned to the policyholder.

Issue 10: Would data availability limit the development of any bifurcation methods discussed in this ITC? To what extent are the models that would form the basis for these methods used to underwrite and price products? Would data availability (or lack thereof) affect only certain insurance forms, products or lines of business / If so, which ones and why?

In paragraph 79 the ITC indicates that models would typically use historical data to bifurcate contracts and would rely on understanding claim loss distributions. In practice, insurance may be priced based on individual or pooled experience depending upon the credibility of data that is available for review. Credibility is a function of size and historical experience. We believe it would be particularly difficult to evaluate expected losses on a policy by policy basis, particularly for medium or smaller group contracts as well as for new customers where the experience period is shorter. In these instances, data used in any model would produce results that were unreliable. We believe this would be a significant issue not only for insurance companies, but for corporate policyholders which not only lack data, but currently lack infrastructure and expertise to process that data. Also of concern to CIGNA is how changes in actual experience could change the bifurcation of the contract. As noted above, we believe variation between accounting models could significantly deteriorate the understandability and comparability of results.

Issue 11: In view of the IASB's project on insurance contracts, should the FASB be considering bifurcation of insurance contracts based on transfer of insurance risk?

It is our understanding that convergence is of great importance to FASB. Therefore, while we do not believe bifurcation will specifically be addressed in the IASB project, we do not believe it makes sense to develop new standards that will significantly change industry practice without the participation of the IASB.

If we can provide further information or clarification of our comments, please call me or Nancy Ruffino (860-226-4632).

Sincerely,  
Annmarie Hagan