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September 6, 2006

Mr. Lawrence Smith
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 61

Via Electronic Mail: director@fasb.org

Re: Invitation to Comment -- *Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting*

File Reference Number 1325-100

Dear Mr. Smith,

Standard & Poor's Ratings Services appreciates the opportunity to provide the Financial Accounting Standards Board our response to the Invitation to Comment on *Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting* (the ITC). The views expressed in this letter represent those of Standard & Poor's Ratings Services and do not address, nor are they intended to address, the views of the McGraw-Hill Companies. Further, our comments are intended to address the analytical needs and expectations of credit analysts.

We believe financial reporting should purport to reflect the true economic nature of an underlying transaction or an arrangement within the financial statements and the accompanying footnotes. Although the ITC may represent an improvement over existing guidance for certain contracts, it can only be viewed as an intermediate step toward a comprehensive revisit of insurance accounting and disclosure standards, because it ultimately does not reflect all aspects of the underlying economics of an insurance contract. We are concerned, however, that the application of the ITC could result in an inconsistent evaluation and recording of similar risks. Further, the ITC does not present a comprehensive alternative to current financial reporting, which must also incorporate further articulation of a required disclosure framework and further guidance on how bifurcation should be addressed over the life of a contract (i.e., the ITC addresses day-one accounting, but provides no guidance as to the ongoing accounting). We believe that application of the 'bifurcation' notion, as currently proposed, will undoubtedly raise significant challenges to our analysts in evaluating the financial implications arising from insurance contracts to both insurers and policy holders. Accordingly, we recommend that the Board not proceed with implementation of the ITC, and instead pursue development of a more comprehensive accounting and disclosure model--preferably jointly with the International Accounting Standards Board (IASB), which will also serve to facilitate consistency in application among global insurers.

We agree with the basic premise expressed by the Board in other recently proposed guidance (e.g., *The Fair Value Option for Financial Assets and Financial Liabilities*) that a full fair value approach is the most relevant basis for accounting for financial assets and financial liabilities, albeit not the only measure. When complemented by expansive disclosures, fair value provides a means to provide users with the most relevant and understandable information regarding an entity's economic position, and allows for a greater understanding of its future prospects¹. In this regard, we believe insurance accounting should not represent an exception; however, in migrating to a more comprehensive solution in this area, the Board must address the manner in which insurance contracts are recorded and reflected in the financial statements--notwithstanding their measurement at fair value (e.g., how insurance revenues and cash flows would be presented and distinguished from financing revenues in the income statement and the statement of cash flows).

These issues are equally germane to the application of the ITC's proposed bifurcation model and must be addressed as part of promulgating any accounting standard that would require bifurcation. We recognize the observed and potential abuses in this area that have prompted the development of the ITC, and welcome the Board's efforts to timely address these critical issues. Accordingly, as an interim step, we recommend the Board require bolstering the disclosure requirements around risk transference, while concurrently pursuing a more comprehensive solution.

We believe that a comprehensive fair value model, coupled with appropriate disclosures², would be more helpful to analysts, both in addressing the concerns caused by the use of finite contracts and in depicting the economic substance of those contracts that meet risk transfer provisions, but still incorporate significant deposit or financing elements. Under a fair value model, contracts would not need to be segregated and evaluated by their contractual elements as required by the ITC, and discounting of assets and liabilities would be consistent to the extent that users of finite contracts would be indifferent to structuring variations often used in an attempt to smooth earnings or obtain surplus relief without having truly achieved risk transference. Further, coupled with appropriate disclosures, the financial statements would provide more relevant information regarding expected cash flows; the variability of cash flows, costs, and revenues; and the factors that could affect these over time and those that affected the past reporting period(s), and so ultimately provide more information regarding the true economic impact of the underlying transaction or arrangement.

Where our analysts have determined that an insurance contract incorporates significant financing elements, they apply an adjustment methodology intended to identify and eliminate or mitigate the financial statement impact of those elements³. This methodology allows us to improve comparability in our analyses of reported results and obligations among those rated issuers that are parties to finite and other contracts with significant financing elements and those that do not, and to better align the reported amounts with what we view under the specific circumstances to better reflect the underlying economics.

The ITC raises numerous concepts that pose significant financial reporting and implementation issues, to both the purchasers and providers of insurance and reinsurance contracts, and to analysts.

Our concerns relate predominantly to the following:

¹ See Standard & Poor's comment letter dated April 10, 2006 on the Board's Exposure Draft of "Proposed Statement of Financial Accounting Standards, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115*".

² Ibid.

³ See also "Property/Casualty Insurance Criteria: Adjusting for Finite Reinsurance" available on www.RatingsDirect.com.

- The proposed bifurcation methodology does not fully reflect the underlying economics and does not provide users of the financial statements with the most relevant information regarding the contractual arrangements. Although the ITC indicates that ‘expected’ losses would be accounted for as deposits, it does not indicate what constitutes expected losses, nor does it provide further guidance on what may constitute an appropriate confidence interval or a probability model to be used in determining these values. A true reflection of the underlying economics of the contract would be reflective of all expected cash flows and would encompass the potential variability of those cash flows. Similarly, the bifurcation model does not address the underlying economics of the portion of the premium attributable to risk transfer. Accordingly, we believe the ITC will not provide users of financial statements with the most relevant information regarding the insurance contracts.
- The ITC screening mechanisms are overly broad and would, unless the limited approach is taken (Par. 61, view A), result in a majority of insurance and reinsurance contracts written being bifurcated.
- Further consideration must be given to presentation, disclosure, and application issues necessary to ensure the results of bifurcation would be understandable to analysts and other financial statement users, and enable comparability between contracts and companies.
- Requiring bifurcation of contracts places significant emphasis on the abilities of the parties to identify and separate contractual elements, and determine and measure those with financing elements versus those representing risk transfer. Because contracts typically are not structured as disparate contractual elements, artificial lines of demarcation may be drawn that do not reflect the most probable level of expected losses. As a result, diversity in practice may arise, making analysis of insurers and reinsurers more difficult. Further, the ITC is not clear as to whether the Board believes bifurcation should be determined only on day one, or whether an on-going assessment would be required.
- Lack of data by purchasers of insurance contracts may have a significant impact on the accounting treatment of the contract, the practical ability of a policyholder to account for insurance arrangements, and the the comparability of results between the purchaser and provider of insurance coverages, as well as among providers.
- Contracts covering multiple risks and/or multiple locations likely would be accounted for differently than contracts covering single risks and/or locations or a cluster of individual contracts, even though the risks and cash flows otherwise would be the same.
- The ITC is not conceptually consistent with either guidance that has been recently exposed for comment (e.g., *The Fair Value Option for Financial Assets and Financial Liabilities*), or with proposals currently being considered by the IASB to measure contracts based on ‘exit’ value. The fair value option (as proposed) allows for insurance contracts to be accounted for under a fair value model, whereas the exit value being considered may be viewed as a proxy for fair value. The bifurcation model does not address fair-value measurements, and would result in further disparate treatments of insurance contracts.
- It is unclear how the ITC would apply to insurance contracts composed of multiple elements such as GMDBs or GMIBs that are currently accounted for under Statement of Position 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*.
- The ITC does not provide guidance on the accounting treatment for transactions costs now accounted for as deferred acquisition costs (DAC).

Because of these concerns, if the Board wishes to pursue bifurcation, we recommend the application be limited to those contracts with elements that are indicative of deposits (and provide for more expansive disclosure requirements) while pursuing a comprehensive longer-term solution. Further discussion of these concerns and other commentary regarding the specific issues for which comments were requested are incorporated into the Appendix.

We previously recommended that the Board undertake a comprehensive review of its conceptual framework, a process that would encompass an evaluation of the appropriate measurement and presentation for all assets and liabilities (financial and nonfinancial, recognized and unrecognized, those held by a consolidated entity or by a joint-venture investee, etc.)⁴. This review should include broader consideration of the information needs of financial-statement users, and provide a more consistent framework for financial statements' presentation and disclosures.

Insurance accounting should not be exempted from this review. We strongly believe users will be better served with a comprehensive, longer-term approach to accounting for insurance contracts. The ITC likely will diminish, rather than improve, the informational value of financial reports to analysts and other users because of the significant implementation issues and its broader application to other non-abusive contracts.

We thank you for the opportunity to provide our input on the ITC. We would be pleased to further discuss our views, and to provide more detailed feedback on the issues with any member of the FASB's staff. If you have any questions, or require additional information, please contact Neri Bukspan, chief accountant at (212) 438-1792 (neri_bukspan@standardandpoors.com) or Ron Joas, director of financial reporting analysis at (212) 438-3131 (ron_joas@standardandpoors.com).

Very Truly Yours,



Neri Bukspan
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Standard & Poor's



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⁴ Ibid

Appendix—Responses to Issues

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 the risk-limiting features, identify those contracts? How could the definitions and descriptions be improved? (page 10)

The IFRS 4 definition of insurance contracts is overly broad insofar as its reference to ‘compensation’ based on uncertain future events that ‘adversely affect’ the policyholder, but does not limit the compensation to losses incurred by the policyholder as a result of the occurrence of fortuitous events, both of which are elements to what is commonly understood to be insurance. We believe the definition of an insurance contract should embed the concept of indemnification, wherein a policyholder does not have an opportunity to realize a gain from the contract; rather, the focus is on placing the policyholder in essentially the same financial position as before the loss event (or up to that position subject to deductibles, caps or partial coverage).

The IFRS 4 definition may be broadly interpreted to include contracts providing coverage for financial risk or otherwise affording the policyholder the opportunity to realize a financial gain from the contract. As a result, contracts that heretofore would not have been considered insurance might be considered insurance under this definition. Similarly, we note this definition conflicts with the scope exception provided to insurance contracts under Paragraph 10(c) of Statement 133, which scopes out those insurance contracts that compensate a policyholder as a result of an insurable event where a liability is incurred or there is an adverse change in the value of a specific asset or liability. This represents a definitional conflict that may result in contracts previously accounted for under Statement 133 being accounted for as insurance.

If a bifurcation is pursued, limiting the definition of insurance is necessary to ensure that a clear delineation exists between insurance and other financial contracts, and to avoid scoping into insurance accounting contracts that otherwise would be accounted for under other guidance. Further, the *definitional discussion in the ITC uses a “contract” as the basis for evaluation. We believe that an appropriate principle-based standard must also encompass an evaluation of the influence and interaction of other contractual relationships between the parties pursuant to other contractual or verbal agreements (e.g., side letters, experience pricing influence in other policies, etc.). In addition, as part of a comprehensive framework review, other contracts that encompass certain insurance-like characteristics and that are currently excluded from insurance accounting treatment pursuant to both the Board’s and the IASB’s definition (e.g., product guarantees provided by sellers and financial guarantees) must be reconsidered, as well.*

We believe the concept of insurance risk as defined by Paragraph 121 of Statement 113 provides an appropriate principles-based definition that should be explicitly referenced in evaluating whether an *insurance contract meets the criteria for insurance accounting.*

Because we are supportive of a comprehensive review of insurance accounting, we do not believe a separate definition for finite contracts is necessary. If pursuing bifurcation on a limited basis, however, we note Standard & Poor’s analytical criteria focuses on material contractual agreements that incorporate risk-limiting features. These are discussed in greater detail in our commentary under Issue 3.

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? (page 11)

As indicated above, we believe Statement 113 provides an appropriate principles-based definition for risk transfer for both insurers and insured. However, we recognize the practical difficulties and the potential lack of data that could hinder a corporate policyholder's ability to effect bifurcation. We also question the cost-benefit elements associated with requiring bifurcation by a policyholder in many cases (e.g., for a vehicle fleet liability cover, group life and health policies, etc.). This does not negate our belief that the criteria are equally appropriate. We encourage the Board to refine a potential "practical" exception that would enable policyholders that are parties to commonly and widely available plain-vanilla arrangements to avoid bifurcation, provided that appropriate disclosures are made (at least as an interim step toward a broader bifurcation model and until more experience is gained).

We further note that other guidance currently exists that indicates enterprises should consider the risk transfer guidance provided by Statement 113 (e.g. EITF Issue 03-8, par. 5), although this guidance is not explicitly referenced in either Statement 60 or in Statement 5, par. 44. Despite this lack of clarity, we believe the criteria for risk transfer should be consistent, regardless of the type of entity, or for the buyer of the contract that provides for risk transfer.

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 contract? Why? (page 14)

Bifurcating significant financing elements and reflecting them as deposits is appropriate for certain contracts within a limited scope where certain deposit elements are sufficiently dominant and serve to modify the predominant economic characteristics of the arrangement. We are concerned that applying the bifurcation notion to a broader population of contracts could serve to diminish, rather than improve, the decision usefulness of financial statements.

Accounting for contracts embodying financing and insurance components in their entirety as insurance does not provide analysts and other users with certain information as to the actual obligation transferred to a third party, the variability of the cash flows the company may ultimately be obligated to fund, or the impact to the company's earnings. However, as contracts often contain numerous features and provisions, bifurcating contracts without providing sufficient supplementary information in the disclosures would be insufficient.

Further, as stated in the body of our letter, additional guidance must be provided on the manner in which income statements and statements of cash flows would be presented and on the accounting for insurance arrangements on day two. For example, suppose an insurance contract was subject to bifurcation on day one, and accounted for in part as a deposit and in part as an insurance contract (i.e., bifurcated). A few months after inception, when the risk elements are quite different, the insurer cedes 50% of the policy to a reinsurer under a 'quota-share' arrangement. If evaluated at that time, the entire contract would be classified as insurance because of a significant change in risk perception (e.g., new seismic data on the

area). We are unclear as to how the contract would be then accounted for (i.e., a whole reconsideration, a reconsideration of 50%, or retaining the original deposit portion, etc.). Accordingly, we are concerned that a mere bifurcation requirement not supported by a comprehensive model not only will not improve the decision-usefulness of insurers and insured financial statements for our purposes, but has great potential to diminish it. Again, this reinforces our view that improving disclosures, while working on a comprehensive solution, will serve users best (which would include requiring disclosures of the contractual provisions, the objective of entering into the contract if not apparent, sensitivity analyses, loss history, and other pertinent data). It would allow analysts to adjust in instances in which they believe the accounting depiction may deviate from the underlying economics without introducing further confusion using a partial model. Analysts are substantially aware of the shortcomings of the current model and the enhanced notes disclosures will further serve to assist us (as an interim step) in making analytical adjustments. It will also foster greater transparency in this area lessening the potential for abuse.

For example, as part of our rating process, we adjust rated insurers and reinsurance companies' capital and earnings models to reflect what we believe is the economic reality of those contracts that do not, in whole or in substantial part, transfer risk. In particular, we focus on certain contractual and qualitative elements in determining the underlying economics of insurance contracts, which include but are not limited to⁵:

- Side letter agreements changing the risk transfer characteristics of the contract;
- Retrocession arrangements to the original cedant or an affiliate of the cedant;
- Commutation clauses allowing for a refund of substantially all of the premiums paid;
- Experience refund or profit sharing agreements;
- Sublimits on exposures;
- Aggregate loss-ratio caps;
- Loss corridors reducing the exposure of the assuming company for a range of specific loss ratios;
- Multiple-year terms;
- Significant deficit or experience refund accounts;
- The intent of the parties entering into the contract (e.g., delaying recognition of losses over a specific time period or true risk transfer); and
- The probability the agreement will be commuted.

Although individually these elements may not indicate a lack of risk transfer, when combined they may result in the economics of the contract being more akin to a deposit for which there is little economic or insurance benefit to the company.

Following are some more specific examples of the proposed model's potential to diminish the usefulness of information in financial statements:

Scope and Unit of Account

In implementing a bifurcation model on a wider scale, further consideration must be given to the appropriate unit of account. For example, should the bifurcation analysis be made by contractual element, location, policy, or on an aggregated policy basis? Different approaches could yield significant variance in accounting outcomes; therefore, the question of the appropriate unit of account is a

⁵ See also "Property/Casualty Insurance Criteria: Adjusting for Finite Reinsurance" available on www.RatingsDirect.com.

significant concern to us in the context of our ability to analyze financial statements produced under the bifurcation framework.

Consider the issue of providing multiple coverages under a single policy, e.g., a policy for five corporate locations under which property, liability, and workers compensation insurance coverage is provided for each. Insurance Company A provides this coverage under a single policy on a scheduled basis, whereas Insurance Company B provides coverage for four of the five locations under one policy, and based on its particular underwriting guidelines and risk assessment requires the fifth location to be issued under a separate policy (for example, to facilitate quota-share reinsurance in a certain area).

As we understand the current framework under the ITC, Insurance Company A (as well as the insured under these policies) would assess all five locations for bifurcation. Because the multiple locations would lead to an expected level of losses for one or more of the perils underwritten, the parties would be required to bifurcate the contract. Insurer B would likewise consider the provisions of the ITC; however, because the fifth location would provide for a single location and peril, it appears this contract would be scoped out of the bifurcation provisions, resulting in bifurcation based on four locations. Similar issues will exist to the accounting by the policyholder. Assume this arrangement is consummated through contracts with five different insurers in each jurisdiction or with a single insurer on a broad corporate-wide policy. We believe the application of the bifurcation model, as currently proposed, may yield different accounting answers in these cases for what we view to be a substantially equivalent economic arrangement.

This example may be further extended to insurance companies that tend to write individual contracts that may be exempted from bifurcation (as the analysis would not be performed in the aggregate), as compared with other companies that would provide coverage for similar risks' group policies (or even single and group policies for identical risks underwritten by the same insurer). Despite the fact that there often are valid business purposes for issuing policies, either separately or on a scheduled basis, we believe the current ITC model could result in providing substantially dissimilar accounting outcomes for substantially similar risks and economics.

Further consideration also must be given to the scope of the ITC. While the examples provided for in Appendix B attempt to scope out personal lines policies, many personal-line policies incorporate premium refund features or discounts for better-than-expected loss performance or policy persistency. Under the characteristics described in paragraph 58e, the inclusion of these types of common risk-limiting features would result in these contracts not meeting the "unequivocal" risk transfer guidance, and would require both policy holders and insurers to undertake a bifurcation evaluation ultimately resulting in many of these contracts having to be bifurcated. Similarly, one could read the ITC as requiring a homeowners policy with scheduled personal property at a secondary location, such as a vacation home, as not meeting the unequivocal risk transfer guidance because of the multiple scheduled locations, thus not affording the 'practical' exception and mandating further analysis. We believe these issues will result in an unnecessary, cumbersome bifurcation-analysis requirement by policyholders for many generic insurance arrangements.

Presentation and Disclosure

Bifurcation would result in the separation of the premium into deposit- and insurance-related premium elements. The ITC does not provide a framework to reflect these elements in the income statement and the statement of cash flows for both purchasers and providers of insurance, relying instead on existing deposit and insurance accounting guidance.

When analyzing the income statement, however, showing risk transfer, deposit, and other revenue elements as separate line items would provide analysts with a better understanding of the types and variability of the revenues and expenses and allow them to perform comparative analysis and projections.

Sufficient disclosure must be provided to enable analysts and other users to understand the impact and underlying economics of bifurcated contracts. Information regarding the timing, nature, range of potential cash flows under the contracts, and information on management's objectives in entering into the contracts should be provided. As many insurance contracts do not contain discrete elements, in our analysis of insurers, we consider information on gross contractual amounts, and how these are presented and separated on the insurers financial report essential. Disclosures should also encompass any side agreements, whether written or verbal, that may affect the policy's cash flows or other contracts with that party. The Board may also wish to consider requiring disclosure of the potential for variability of cash flows that could occur under specified conditions using, for example, a value at risk, or other method used by the insurer for measuring risk.

Incorporation of these disclosures would allow users to evaluate the sensitivity and reliability of the information presented, the discretion applied in selecting assumptions, and allow for better comparisons among contracts and companies. The greater transparency arising from these disclosures may also result in market forces imposing greater discipline on assumptions used and actions taken by management.

Application of Confidence Intervals

Different methods of assessing the probability of payouts under a contract will result in a lack of comparability between contracts. Consideration should be given to providing guidance regarding the confidence interval when reflecting deposit elements of contracts. To illustrate this point, consider Contract A, which has an annual premium of \$100, with a 100% probability of paying \$10, and a 40% probability of paying \$150. Clearly the \$10 would be booked as a deposit; however, it is not clear what additional amount, if anything, should be booked for the remaining premium to reflect additional deposit element. The alternatives include booking the probability-weighted amount of \$60 (40% x \$150); recording \$0 using a FAS 5 approach (whereby the 40% is not probable of being paid); or some other confidence interval-weighted approach. Further, as previously discussed, it is unclear whether a different accounting outcome would be reached if the insurer has underwritten 1, 5, 500 or 5,000 identical policies, individually or as part of a group policy.

Data Asymmetry

The broad scope of the ITC also underscores the potential for an asymmetric treatment by insurers and policyholders and the importance of availability of data to policyholders, as well as a significant cost-benefit issue related to the enhanced usefulness of financial statements of policyholders where such contracts are subject to bifurcation.

As described in our example with Insurance Company A, above, a policy with five locations must be bifurcated between deposit and risk-transfer elements. However, the data by which the deposit element is determined will differ, as will the methods by which that data is assessed.

Insurance Company A may base its assessment on the historical loss experience particular to the policyholder. Likewise, it may base its assessment on the overall historical loss experience for a particular coverage, a group of insureds within a particular program, or a group of similar coverages.

This assessment may also depend on the assessment of loss trends and choice of actuarial methodologies. Conversely, the policyholder may base its assessment on the historical or expected losses from particular location or coverage, on the entity as a whole or on similar locations, etc. The differences in data being used in estimating the expected losses will result in significantly different assessments of the expected losses. Further, the foregoing presupposes the existence of the necessary technical expertise. While this assumption is not unreasonable from the provider perspective (using actuaries to determine pricing for coverages), the vast majority of purchasers do not, in fact, have such expertise, and rely predominantly on an assessment of the insurer's reputation, rating, services provided, and the premiums charged to determine a reasonable price for the insurance coverage being provided.

The differences in assessments also will be evident between insurance companies. The bifurcation of contractual elements and the data used to assess bifurcation will differ between insurance providers, resulting in significant diversity in practice and significantly complicating our efforts to analyze companies. Although we recognize that diversity is an unavoidable element of an accounting system that incorporates numerous discretionary and modeled valuation elements, we believe the ITC does not provide sufficiently comprehensive framework that would allow analysts to understand the drivers influencing the amounts recorded in the financial statements and their potential susceptibility to future variations.

Day-Two Accounting

The ITC does not provide direction on whether a bifurcation analysis is a one-time endeavor or should be done on an ongoing basis over the term of the contract. Further guidance is needed about the circumstances under which contracts may need to be reevaluated, particularly given the prevalence of endorsements to increase, reduce, or otherwise change insurance policy coverages, which could change both a bifurcation analysis and result in certain of the practical 'exemptions' being lost. The ITC does not indicate whether and how a contract would be assessed if changes occur after inception.

For example, an insured takes out a policy with a single covered vehicle on January 1, adding an endorsement at a later date for several additional vehicles; further clarity should be provided as to whether this contract must be reassessed under the bifurcation model.

A related issue is what portion of the acquisition costs should be attributed to deposit, rather than insurance elements: It is not clear that the costs incurred for deposit and insurance elements would be amortized at the same rate over the life of the contract, given insurance premiums and associated costs may be recognized in proportion to the risk coverage provided (Statement 60, par. 13) and how reconsideration of contracts, when endorsed, would affect these deferred costs.

These comments represent only some instances of what we believe to be significant application and implementation issues, making it difficult for us to comment more fully on the viability of the application of a bifurcation model and its usefulness for our purposes. Because of the sheer complexity of insurance arrangements and the vast number of issues to be addressed, we recommend that the Board limit the application of bifurcation to those contracts with contractual provisions such as those discussed above, while undertaking a longer-term project to consider the insurance accounting model on a more comprehensive basis, preferably jointly with the IASB.

Issue 4: The flowchart suggests a sequence for analyzing contracts that integrates current insurance accounting guidance with a hypothetical bifurcation analysis. Do you believe that the sequencing and integration are appropriate? What changes would you propose? (page 17)

Consistent with our comments, Standard & Poor's believes the scope should be limited. Accordingly, Steps "c" and "d" in paragraph 56 would be revised and limited to identifying and bifurcating those contracts with the contractual elements noted above.

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 paragraphs 57–59? (page 18)

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 Statement 113 (summarized in paragraph 37(c) of this Invitation to Comment)? (page 18)

Issue 7: Do you prefer Approach A or Approach 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? (page 20)

Please refer to our general commentary as well as our comments under Issue 3.

Issue 8: Should the criteria for bifurcation be different for insurance contracts and reinsurance contracts? Why? If yes, what differences would you suggest? (page 20)

Because insurance and reinsurance contracts represent the same fundamental purpose of transferring and sharing risk of loss among parties, the type of entity doing so should not be a determining factor in the accounting applied. Accordingly, we believe both insurance and reinsurance arrangements should be subjected to similar testing criteria.

Issue 9: Which of the methods identified in this Invitation to Comment 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 this Invitation to Comment? (page 22)

The expected payout method, incorporating for contracts with commutation clauses the economic triggering point where it would be beneficial to commute the contract, appears to be the most consistent with our current methodology, whereby those elements not exhibiting significant variability in cash flows as a result of a fortuitous event are considered to be deposit amounts, and adjusted for accordingly within our capital and earnings models.

However, we do not believe a single methodology is appropriate in all circumstances and for all types of contracts. Further, we believe different methodologies may be more appropriate pursuant to a broader

“fair value” model. We therefore recommend that the Board require the use of appropriate and commonly used actuarial methodologies that will be appropriately disclosed and that are also consistent with the method used by the entity for valuation, pricing, and risk management purposes. The disclosures may follow similar pattern to those currently proposed as part of the Board’s *Proposed Statement on Fair Value Measurements*.

As to policyholders, the issues we see are twofold: Availability of underlying data (e.g., actuarial) regardless of the methodology chosen; and depending on their level of sophistication, certain methodologies may be more cumbersome than others. We wish to emphasize again the potential for asymmetric accounting, and our concern that in many cases bifurcation by policyholders, for most prevalent insurance contracts, would not result in enhanced information provided to analysts. In fact, in most cases it may be diminished.

Issue 10: Would data availability limit the development of any of the bifurcation methods discussed in this Invitation to Comment? 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? (page 23)

As previously stated, we believe there may be data availability and expertise issues from the perspective on a non-insurance company purchaser of insurance products. Many of these entities may not have the necessary expertise, whether actuarial or other, to analyze these contracts. In many cases, they would be reliant on the insurance providers and their experts, so we question the utility of the data and the assumptions if they are not subject to independent verification.

If a broader bifurcation model is pursued, we recommend the Board consider providing a practical exception to non-insurance parties by expanding the current unequivocal test guidance, pursuant to which bifurcation will not be required for generic contracts (even if these contracts include a perceived deposit element, such as group policies with relatively certain actuarial level of inherent losses, because of the size of the group), provided the pertinent provisions are disclosed and the reporting company specifies the reason a bifurcation analysis is not undertaken (e.g., limited number of contracts, lack of expertise or data, etc.).

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? (page 24)

As indicated previously, if bifurcation is pursued independent of a comprehensive solution, it should be done on a limited basis. We recommend the Board pursue a longer-term project focusing on implementing guidance that would fully reflect the economic substance of insurance contracts, whether utilizing a fair value or other applicable model.

This approach is in keeping with the Board’s broader objective of converging guidance with the IASB, which Standard & Poor’s strongly supports, and would allow the Board to take a more considered and comprehensive approach to determining what information financial statement users would find most useful and relevant and how financial assets and liabilities resulting from insurance contracts are best reported in financial statements.