



LETTER OF COMMENT NO. 28

Factory Mutual Insurance Company
1301 Atwood Avenue
P.O. Box 7500 Johnston, RI 02919 USA
T: 401 275 3000 X: 1550 F: 401 275 3028
jeffrey.burchill@fmglobal.com

Jeffrey A. Burchill
Senior Vice President - Finance
Chief Financial Officer

August 21, 2006

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

**Re: Invitation to Comment on Bifurcation of Insurance and Reinsurance Contracts
for Financial Reporting (File No. 1325-100)**

We appreciate the opportunity to respond to the Invitation to Comment on Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting. FM Global is one of the world's largest commercial and industrial property insurance and risk management organizations specializing in property protection. More than one out of every three Fortune 1000 companies, as well as leading international corporations, have in-force insurance policies with an FM Global company.

While we are not going to comment in detail on each of the eleven issues identified in the Invitation to Comment, we generally feel that the current guidance on accounting for reinsurance is adequate and, if necessary, that the guidance would need only minor clarifications of what is intended by *significant loss* and *reasonable possibility*. The finite reinsurance restatements that have been recently publicized appear to involve contracts in which an appropriate detailed transfer of risk analysis was not used as the basis for classifying the contract as insurance. These restatements were the result of a lack of compliance with existing authoritative guidance not the lack of authoritative guidance. Given the fact that the abuses have received so much attention, transfer of risk is now considered a more high risk audit area and both external and internal auditors are focusing more attention in this area. We believe that this increased scrutiny will alleviate the risk of non-compliance with the existing transfer of risk authoritative guidance.

Additionally, we believe that attempting to bifurcate contracts would make the accounting more complex, judgmental, and difficult for users of financial statements to

understand. The possible bifurcation approaches outlined in the Invitation to Comment are principles based approaches to bifurcating insurance and reinsurance contracts and as such only introduce more judgment into the accounting for these contracts. The very principle of insurance is that losses are fortuitous and outside the control of the parties to the contract, whereas the theory of bifurcation implies that these contracts can be reasonably segregated into financing and transfer of risk components. In fact the very theory of transfer of risk is that the contract must be subject to variability in both the timing and amounts of cash flows in order to qualify for insurance accounting. This variability makes it very difficult to clearly distinguish the risk transfer and financing components of an insurance or reinsurance contract.

We believe that requiring the application of new bifurcation guidance to insurance contracts that do not meet the characteristics of contracts that unequivocally transfer significant insurance risk, as currently defined in the invitation to comment, will result in costs of implementation that exceed any potential benefits to users of financial statements.

Our responses to the select issues on which we intend to comment are as follows:

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 risk? If not, how can the Statement 113 guidance be modified or clarified to apply to insurance contracts?

Paragraph 10 of your Invitation to Comment states, "For many individual insurance contracts such as personal auto or homeowners, neither the policyholder nor the insurer expects any claims during the contract term – the contract provides protection if an insured event occurs. On the other hand, the insurer expects claim losses on the portfolio of contracts. The *pooling* or *spreading* of risks is an important function of insurance – the pooling of risks and premiums from a large number of policyholders to pay the claims of the small number of those policyholders who suffer an insured loss." But the concept of pooling or spreading risk is not isolated to only personal auto and homeowners policies. It is the basic premise of all insurance. As a large commercial property insurer we see significant loss variation on our policies regardless of the number of locations insured. In fact, we see significant gross loss variation in our entire insurance portfolio from year to year, which is why we purchase catastrophe reinsurance. Given that we can not predict gross losses on our entire insurance portfolio accurately from year to year, we do not see how it would be possible to reasonably predict losses at an individual policy level. As a point of reference, FM Global has approximately 3,000 customers and in any one calendar year anywhere from 10% to 33% of those customers may sustain a covered loss.

Given that the transfer of risk criteria would have to be applied to all contracts that do not meet the characteristics of contracts that unequivocally transfer significant insurance risk, reasonably possible outcomes would have to be developed for each policy that our

company issues. Furthermore, since we issue policies that cover multiple locations it is not clear that our contracts would meet the definition contained in the invitation to comment of unequivocally transferring significant insurance risk. As such, we would be required to document whether we need to bifurcate our insurance contracts, even though, as discussed in the previous paragraph, we see significant loss variation on our policies. Given the complexity of our contracts there are an infinite number of reasonably possible outcomes that could occur, for each policy we issue from a scenario of no covered losses to scenarios with multiple covered losses. The scenarios used would have to take into consideration the complex structure of our contracts and would require a substantial amount of time and expertise to develop. However, since our contracts do not contain any special risk limiting features and our losses are short-tail in nature we believe that all of the contracts would meet the transfer of risk requirements in Statement 113. As such, we would be required to perform an extraordinary amount of work to support our transfer of risk position with no anticipated material impact on our accounting for the contracts.

To address this issue we suggest that you modify the criteria used to determine whether there is unequivocal transfer of insurance risk to include policies which cover multiple locations but contain significant loss variation.

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?

We believe that the Types of Contract criteria for contracts that unequivocally transfer significant insurance risk should be expanded to include all contracts that have short-tailed loss experience regardless of the number of risks or the number of assets, liabilities or events at risk. Bifurcation is attempting to isolate contracts into financing and insurance risk components. Insurance contracts with short-tailed loss experience, such as property coverage, do not have a significant financing portion of the premium due to the fact that losses are paid over a relatively short period of time and no individual contract expects losses to occur annually.

Additionally, we believe that the Required Characteristics criteria should be modified as follows:

1) We believe that characteristic (f) that requires that the contract is not likely to result in any claims should be changed to read that "It is reasonably possible that the contract will not result in any claims." Given that premium for a policy that covers multiple risks or multiple assets, liabilities or events is determined, in large part, by allocating premium for each individual risk or exposure in the same manner as if each risk or exposure were individually insured we do not feel that just because multiple risks or exposures are covered under only one policy, versus multiple single risk policies, that the accounting treatment should be different. In fact, due to the increased policy issuance costs that would occur if multiple policies were issued, it is likely that a larger portion of the

premium charged for a policy which covers multiple locations would be attributable to risk transfer.

2) We recommend that Required Characteristic (d) be changed as follows:

The contract has a market-equivalent level of premium and the premium is not a substantial percentage of the maximum coverage provided. Any deductibles and coverage limits are fixed.

We recommend this change because it is often difficult to substantiate that the deductible and coverage limits are based on standard market terms since policies which insure large commercial property are designed specifically for each insured based upon the risk assessment of their portfolio of properties.

In summary, we believe that current guidance for reinsurance accounting is sufficient as adopted. We feel that any perceived abuses that are currently being attributed to "professional judgment" could be alleviated by issuing implementation guidance that clarifies what is meant by *significant loss* and *reasonable possibility* in Statement 113. This implementation guidance could include examples of scenarios that would be expected to meet and not meet the transfer of risk requirements in Statement 113.

Additionally, we believe that application of Statement 113 or any new proposed bifurcation guidance contain an exclusion for short-tailed loss contracts that do not contain any special risk limiting features regardless of whether the contract covers a single risk or multiple risks. Without this exclusion, transfer of risk analysis would be required to be performed on contracts that clearly transfer significant insurance risk. The cost of implementation would be significant while the disclosure contained in our financial statements would not change.

We appreciate the opportunity to express our opinions on your Invitation to Comment on Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting. We hope that our opinions are useful as you continue to deliberate over the appropriate accounting treatment for insurance and reinsurance contracts. Should you have any questions regarding our comments or wish to discuss any of our response with us, you can contact me at (401) 275-3000 extension 1550.

Respectfully,



Jeffrey A. Burchill
Senior V.P. and C.F.O.
FM Global