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Technical Director
File Reference No. 1325-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Subject: Comment Letter Regarding Bifurcation of Insurance and Reinsurance Contracts

Dear Director:

American Electric Power Company, Inc. (AEP) appreciates the opportunity to respond to the Financial Accounting Standards Board's (FASB or the Board) Invitation to Comment (ITC) on Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting, dated May 26, 2006. AEP, a Columbus, Ohio based energy company, is one of the largest investor-owned utilities operating in the United States, with revenues of over \$12 billion and more than 20,000 employees. We provide energy to approximately 5 million customers in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia and West Virginia. We believe the following six key observations should direct the FASB's consideration of accounting for insurance and reinsurance contracts:

- Although we understand that the FASB has not reached any tentative conclusions, we strongly believe that the ITC applies a much too finely detailed and rules-based approach for separating elements of risk and financing (even if the expected claim payments are insignificant). As a corporate buyer of insurance, we do not have the data available to bifurcate insurance contracts as proposed and we are concerned about broader implications if the Board pursues this approach; for example, the expected payment approach could also be analogized to other contract issues such as warranties.
- We recognize the importance of the Board's concern about recent restatements related to finite risk
 insurance and reinsurance contracts. We nevertheless agree with those who assert that the misstatements
 were the result of misapplications of current and adequate accounting guidance to side-contracts. We
 believe the existing GAAP guidance for determining significant risk transfer for reinsurance has long
 been applied in practice to insurance contracts by analogy and thus, no new guidance is necessary.
- Based on the views expressed in the ITC, very few commercial insurance contracts could be classified as
 insurance in their entirety based on the proposed characteristics of contracts that unequivocally transfer
 significant insurance risk. Arbitrary bifurcation of insurance contracts using an expected claim payment
 approach is illusory precision and would lead to inconsistent information and incomparability between
 insurance companies and corporations. It would not provide any better information about a company's
 use of insurance to manage risk.

- Classification of entire contracts as insurance or a deposit, rather than bifurcation, more faithfully represents the economic substance. Insurance contracts are negotiated as a single transaction, and cannot be objectively separated into risk transfer and non-risk transfer components, which require use of subjective assumptions and arbitrary bifurcation techniques. Even if certain non-risk transfer components can be identified, they cannot reliably be assigned a value. Since commercial policyholders do not have the data necessary to separate the insurance premium into insurance and financing components, the cost of obtaining data from actuaries would greatly exceed any perceived benefit. These estimates would need to be revised at least quarterly, with expense recognition of the non-refundable but imputed "deposit" as claims are incurred. We believe that this non-refundable "deposit" is not an accurate presentation for financial reporting purposes.
- Recognition of insurance expense over the contract period provides better matching and more meaningful
 and consistent information to financial statement users. Insurance expense for major non-insurance
 companies is largely not material and the proposal seems to be primarily affecting timing of expense and
 classification.
- We believe any new guidance should be considered in conjunction with the IASB's phase II insurance project rather than creating new approaches to insurance that will soon need to be reconsidered.

We have attached a response to the eleven specific issues raised in the ITC.

Sincerely

Joseph M. Buonaiuto

Attachment

Attachment

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)

We believe the definitions of insurance contract and insurance risk are sufficient. We do not believe it is necessary to attempt to define "finite" insurance and reinsurance contracts. Many traditional insurance contracts will have the same types of features, so the descriptions are not useful.

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)

Although the cash flow analysis in Statement 113 to determine significant risk transfer requires actuarial data not readily available to corporate insureds, we believe the current Statement 113 risk transfer guidance has been applied qualitatively by corporate policyholders in practice. No further mathematical exercises would be practical to apply.

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)

We believe classifying an entire contract as insurance or deposit provides more understandable and decision-useful information, and more faithfully represents the economic substance of the contract. Insurance to a major company is largely not material. The proposal seems to be primarily affecting timing of expense and classification, as interest instead of insurance premium. We believe it is inappropriate to characterize a portion of an insurance premium as a deposit, when it cannot be refunded and the insurance contract provides coverage for the expected claims. We believe the SFAS 113 guidance already allows significant elements to be segmented.

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)

We do not believe that insurance contracts should be bifurcated, as it would be simply a hypothetical exercise, subjective, dependent on largely unavailable data and accomplishing little. Statement 113 is a principles-based standard that should be enforced, rather than creating new guidance.

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)

We do not agree with the characteristics identified for contracts that do or do not unequivocally transfer significant risk. We believe the examples and discussion are overly simplistic and not representative of the complexity of insurance contracts used in reality. In particular, the list of contract types in paragraph 58 is much too narrow to be used in practice. With respect to required characteristic d, there is no objective measure of a "market-equivalent level of premium" or "standard market terms". Additionally, many

traditional insurance contracts will have risk-limiting features, which item 3 prohibits for unequivocal transfer of risk.

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)

We do not believe the characteristics in paragraph 58 provide an improvement over Statement 113. As proposed, essentially no contract will meet the characteristics for unequivocal insurance, making it a meaningless analysis.

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)

We do not agree insurance contracts should be bifurcated. If it were required, we would support Approach A, because it is the closest to Statement 113 by attempting to identify only those contracts with a significant financing component.

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)

If bifurcation were required, we support using the same criteria for insurance contracts and reinsurance contracts, but again, we do not believe new guidance is needed for insurance or reinsurance contracts.

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)

We do not believe insurance and reinsurance contracts should be bifurcated. We believe there would be significant undue cost for corporate policyholders to obtain the required data from actuaries for each of the methods identified in the ITC and the resultant bifurcation would not match the policyholder's data.

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)

We believe data availability would definitely limit the development of all of the bifurcation methods discussed in the ITC, particularly for corporate policyholders. Bifurcation is an academic theoretical exercise which changes the timing of expense only, with no benefit.

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)

We do not believe the FASB should be considering bifurcation of insurance contracts based on transfer of insurance risk when it would lead to divergence from the IASB and the FASB's mission includes convergence with international standards.