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Ms. Suzanne Bielstein  
Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

**RE: File Reference No. 1325-100**

Dear Ms. Bielstein:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the Financial Accounting Standards Board's ("FASB" or the "Board") Invitation to Comment entitled *Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting* (the "ITC").

We had understood the original objective of the risk transfer project was to focus on existing practice problems. We expected this project to produce interpretive, clarifying guidance on the existing principles and concepts embodied in FAS 113 and other existing insurance accounting guidance, perhaps in the form of an FASB Staff Position. We observe that the project has expanded into a much broader scope requiring bifurcation of insurance contracts and subjecting an unwieldy number of contracts, particularly under Approach B to Issue 7, to a bifurcation screen and detailed risk transfer analysis. We believe the changes being considered by the ITC will introduce potentially significant changes to the basic insurance accounting model for insurers, reinsurers and purchasers of insurance. We are not supportive of such a broad scope project for the following reasons.

1. We believe that many of the practice issues that led to this project can be addressed by providing guidance utilizing risk transfer principles that already exist in U.S. GAAP. For example, the principles in FAS 113 provide a basis for developing clarifying guidance on risk transfer and on accounting for contractual deposit elements of contracts with significant risk limiting features. EITF 93-6 effectively requires bifurcation of certain contractual elements of reinsurance contracts. Our specific recommendations to strengthen EITF 93-6 guidance are included in Appendix A to this response. Other practice problems, such as those stemming from oral or written side letters or other

related contracts that effectively mitigate risk transfer resulted because preparers did not apply an explicit principle; not because there is a lack of applicable guidance.

2. The time and resource necessary to complete a broad scope project will delay the timely resolution of the primary practice problems that the initial proposal was designed to address. For example, based on our discussions with preparers, actuaries, and accountants of the ITC's suggested possible approaches to bifurcation, none of the suggested methods are widely recognized or have been sufficiently tested. Thus all of the methods require considerable research, development, and analysis before a standard that requires bifurcation would result in financial reporting that is comparable, useful, and understandable to financial statement users. The significant changes suggested by the ITC, including these bifurcation methodologies, will require much more in-depth study, and more time before a final standard could be achieved and implementation could begin.
3. We support the FASB's long-term strategic objective of working with the IASB to develop a common set of high-quality global standards. Given that the IASB has already devoted significant time and effort to developing an insurance accounting model in its IFRS 4 Phase II project, it would seem contrary to the FASB's long-term objective if it separately embarked on a large scale reconsideration of existing insurance accounting guidance at this time. Moreover, the changes under consideration in the ITC would likely require corporate policyholders, insurers, and reinsurers to implement costly revisions to policies, systems, and processes. Unless such changes were compatible with the results of the IASB's project, these entities could incur a second round of incremental compliance costs, which we would not favor.
4. The suggestions in the ITC would likely result in significant changes in the accounting for more traditional insurance and reinsurance contracts. For example, most reinsurance contracts and many insurance contracts would not pass the "unequivocally transfer risk" criteria and would thus be subject to required bifurcation under Approach B of Issue 7. We see no reason to promulgate such changes when no perceived problems or abuses exist for such contracts.
5. The ITC suggests revisions to the accounting model that could result in financial reporting that does not reflect the economic substance of the arrangement. For example, the changes suggested by the current definition of contracts that unequivocally transfer risk could result in different accounting treatment by an insurer for the ceded and retained portions of direct contracts written and then ceded to a reinsurer. If the direct business policies written by the insurer cover single risks (and thus aren't subject to bifurcation), but those risks are ceded on a pure 100% quota share basis to a reinsurer, the concepts

proposed in this ITC may require bifurcation of the ceded quota share contract. We believe that would not reflect the economic substance of the combined arrangement.

6. The insurance bifurcation concept and models proposed in the ITC would not, in our view, be easily understood or applied, and could be very complex to implement for insurers and reinsurers, but especially for non-insurance company policyholders. When contemplating the development of any accounting guidance, we encourage the FASB to be mindful of the need for, and the benefits of, simplicity and understandability.
7. The bifurcation of insurance contracts would not result in an enhancement of the quality or usefulness of financial statements of corporate policyholders, for which insurance costs are generally a much smaller component of the financial statements and for which accounting for a contract under the insurance model or deposit model would not be expected to significantly impact revenues or the financial ratios used by analysts and investors.

We favor a project confined to a limited scope aimed at producing guidance that utilizes existing principles in U.S. GAAP to address immediate practice concerns. We believe it could be completed in a shorter time frame. Our specific suggestions are described in Appendix A to this response.

We have not provided specific responses to each question, although our comments, including those in the appendix, address matters in Issues 2, 3, 5, 7, 9 and 11 of the ITC. We have also provided a response to some of the questions in Issue 1 in Appendix B to this response.

\* \* \* \*

Once again, we appreciate the opportunity to express our views on the Invitation to Comment. If you have any questions regarding our response, please contact Don Farnan at (973) 236-4189 or Mary Saslow at (860) 693-4407.

Sincerely,

*PricewaterhouseCoopers LLP*

PricewaterhouseCoopers LLP

**Appendix A**

**Refocus the Project to a Limited Scope Project to Address Current Practice Issues**

**(1) Application of FAS 113 risk transfer guidance to insurance contracts:**

We believe that the qualifying criteria for applying the insurance accounting model should not be different for the policyholder, insurer, or reinsurer. This is consistent with the EITF's observation in EITF 03-8, which states "The Task Force observed that paragraph 44 of Statement 5 requires that an enterprise determine whether insurance risk has been transferred through an insurance contract; entities may find the conditions in Statement 113 useful in assessing whether an insurance contract transfers risk." Accordingly, while the explicit requirement in FAS 113 to transfer both timing and underwriting risk are absent from FAS 5, paragraph 44, which describes only the "indemnification" concept, we believe the FAS 113 risk transfer test should apply to insurance as well as reinsurance contracts.

However, we recognize that if purchasers of insurance contracts are required to apply the FAS 113 risk transfer test, they would need to perform a quantitative (cash flow) analysis with respect to many more contracts than is being performed currently. We believe formalization of accounting practice for contracts that unequivocally transfer significant insurance risk, as discussed in (2) below, could reduce the volume of contracts that would require the quantitative application of paragraph 9(b), especially for policyholders.

**(2) Formalize accounting practice for contracts that unequivocally transfer significant insurance risk:**

We believe that the proposed criteria in paragraph 57 and 58 of the ITC, which identifies whether contracts unequivocally transfer significant insurance risk, is too restrictive, specifically because the criteria for exclusion are limited to insurance of a single risk or single contract. The population of contracts that would be subject to detailed risk transfer analysis would be extremely large and the cost and effort of performing that analysis for such a large population of contracts would be substantial. Thus, we believe that the single occurrence and single asset/liability criteria in paragraphs 58 (a) through (c) should be eliminated. However, we believe that the concept embodied in paragraph 58(f) should be codified to formalize the current practice of insurance and reinsurance accounting for contracts with a remote possibility of occurrence (and thus technically fail the existing 9b "reasonably possible" provision) but high potential severity of loss. Treatment as other than insurance would not reflect the economic reality that risk has been transferred. We recommend that guidance similar to that in paragraph 58(f) be promulgated to support a practical application of the concepts in FAS 113 by corporate policyholders and ceding

insurers. We believe that will promote accounting that reflects economic reality. However, since the term "not likely" in paragraph 58(f) is not defined in U.S. GAAP, we recommend the term "remote" be used.

(3) Accounting for deposit elements of insurance and reinsurance contracts:

U.S. GAAP already includes a basic principle in support of separate accounting for the contractual deposit element of an insurance or reinsurance contract. For example, a reasonable interpretation of paragraph 18(a) of FAS 113 and paragraph 44 of FAS 5 would support bifurcation of contractual deposit elements of insurance and reinsurance contracts by policyholders, insurers, and reinsurers. Accordingly, a contract provision that requires an experience refund or similar repayment to be made to the insured/ceding company if experience is positive (or loss reimbursement payment if experience is not) is effectively a specified fixed payment provision, the amount of which should be treated as a deposit element of the contract.

We further believe that this basic principle of bifurcation is evidenced in EITF 93-6, "Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises," which effectively requires bifurcation of contractual features for which the economic reality is that certain portions of amounts exchanged between parties (usually included in "premiums") will be returned to the original party that paid such amounts absent experience under the contract - these are essentially financing elements to the arrangement. Q&A 25 of EITF D35, expressing the Staff's views on EITF 93-6, supports this principle that for the portion of a contract that represents a contractual deposit element that is not, in substance, part of the amounts paid for insurance, treatment as a deposit is appropriate.

We recommend that the FASB take steps to ensure that the principles embodied in EITF 93-6 are applied in practice to all contractual deposit elements of insurance and reinsurance contracts by clarifying that the consensus applies not only to premium adjustments, but other adjustable features such as experience refunds. In addition, we recommend that it be made clear in the guidance that once deposit accounting is applied to an element, it should continue to be applied to that element. Q&A 25 of D35, while acknowledging in early parts of the discussion that the contractual component is a deposit, is sometimes interpreted to allow for treatment as reinsurance later on when it says "unless and until a future event (loss) occurs that eliminates the ceding enterprise's right to receive the amount, it is not part of the cost of reinsurance, and must be recognized as an asset."

(4) Application of EITF 93-6 and EITF 93-14 to multi-period insurance and reinsurance contracts:

We recommend that the guidance in EITF 93-6 apply to both single-year and multi-year contracts. Currently EITF D-35, Q&A 6, could be read to imply that the concepts in EITF 93-6 do not apply to single year contracts. However, the answer in Q&A 6 hinges on the creation of benefits or obligations in a "future accounting period" and we believe it is appropriate to apply that test to contracts with multiple periods, such as those that span more than one fiscal quarter. In our view, the same accounting should apply, whether the contract is a multi-year or a multi-period contract. Additionally, since EITF 93-14 makes clear that this same model is applied to non-insurance entities with similar contracts, our recommendation applies to EITF 93-14 as well.

(5) Mandatory premium reinstatements:

There appears to be diversity in practice on the treatment of mandatory premium reinstatements, as evidenced by a recent survey by the AICPA Insurance Task Force. If such mandatory payments are based on loss experience, we believe they should be accounted for under EITF 93-6, even if they relate to single year contracts (see #4 above).

(6) Interpretation of FAS 113, paragraph 9 (a):

Industry practice suggests that there is inconsistency in applying paragraph 9(a) to certain reinsurance contracts. As explained more fully in a letter dated November 18, 2003 from AcSEC and the AICPA Insurance Expert Panel, the FASB should clarify the paragraph 9(a) "significant risk transfer" test as it is not clear how this is practically applied to contracts with risk limiting features. Paragraph 62 of FAS 113 expands on the definition of significant insurance risk, noting "implicit in this condition is the requirement that both the amount and timing of the reinsurer's payments depend on and directly vary with the amount and timing of claims settled under the reinsured contracts." Consider a contract with an experience refund, a loss corridor (e.g., loss ratio for which coverage is not provided) and a cap (losses not reimbursed above a specified loss ratio). A significant portion of the payments have no variability (i.e., up to the top of the loss corridor and in excess of the cap) to the reinsurer. The issue is whether this would automatically preclude the transfer of significant insurance risk. We believe it would not, but we acknowledge that there is a diversity of views.

(7) FAS 113, paragraph 11 exception:

In our view, paragraph 11 of FAS 113 is a very narrow exception to the paragraph 9(a) and 9(b) risk transfer tests, and the answer in Q&A 23 of EITF D-34 supports this. We are aware, however, of a divergence in practice in

applying paragraph 11. For example, some companies believe paragraph 11 applies to quota share contracts with caps/limits and/or experience refunds. Since "trivial" is not defined in U.S. GAAP and there is uncertainty as to how this should be measured, this diversity persists. We recommend that the FASB provide additional interpretation of paragraph 11 to address the practice issues that have developed.

Appendix B

*Issue 1: Does the IFRS 4 definition of insurance contract identify insurance contracts and sufficiently distinguish those contracts from other financial contracts? Does the US 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 risk-limiting features, identify those contracts? How could the definitions and descriptions be improved?*

While a single formal accounting definition of an insurance contract is not present in U.S. GAAP, we believe existing U.S. GAAP literature provides clear guidance as to what is and what is not an insurance or reinsurance contract. That guidance can be found in FAS 60, FAS 113, FAS 5, and FAS 133, paragraph 10(c). Thus, in our view, a formal definition is not necessary.

We also believe there is no substantive difference between the U.S. GAAP concept, one of indemnification, and the IFRS definition of insurance contract, which refers to compensation. For example, FAS 133 includes the notion of compensation.

Moreover, we believe adopting the IFRS 4 definition of insurance contract while retaining the U.S. GAAP definition of insurance risk may require some modification. The IFRS definition of insurance *contract* does not exclude financial risk. That exclusion is instead provided in the IFRS definition of insurance *risk*, which specifies that insurance risk includes "risk, other than financial risk, that is transferred..." a distinction that is not considered in the ITC. By adopting the IFRS definition of insurance contract but not the IFRS definition of insurance risk, financial risks such as covered call options may qualify as insurance contracts. We believe that result would not be appropriate. Accordingly, to avoid that result we would recommend referencing the FAS 133, par. 10c definition of insurance contract, which indicates that that an insurable event is other than a change in price.