



LETTER OF COMMENT NO. 27



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

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

Dear Technical Director:

CNA appreciates the opportunity to respond to the Invitation to Comment on Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting (ITC). CNA is the country's seventh largest commercial insurance writer and the 14th largest property and casualty company. CNA's insurance products include standard commercial lines, specialty lines, surety, marine and other property and casualty coverages. CNA's services include risk management, information services, underwriting, risk control and claims administration.

We do not support the concepts that are contained within the ITC. We do not believe that bifurcation of insurance contracts into insurance and deposit components will improve the understandability and decision usefulness of financial statements of either insurance companies or their policyholders. Indeed, we believe that the concept of bifurcation would dramatically increase the complexity of insurance company financial statements and disclosures. We believe that readers want financial information presented in the context of how the business is managed. The bifurcation model would create a completely different set of financial information that could not easily be analyzed in the business context.

Bifurcation would add significantly more subjective judgment in the determination and compilation of financial information in order to create a 'bright line' between insurance and deposit components in insurance contracts where such 'bright lines' currently do not exist. We believe that the numerous assumptions required to bifurcate insurance contracts will result in financial information that is less understandable, has less predictive value, and is more difficult to verify. The additional subjective judgment and the numerous assumptions implicit in the bifurcation model would result in less comparability across insurance companies' financial statements. The processes that would be required to adopt bifurcation concepts would add significant administrative cost to the insurance industry, including insurance agents and brokers, and to its policyholders.

The remainder of this letter addresses the specific issues contained in the ILC and further elaborates on our conclusions.

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?

We believe that the definition of insurance contract, for purposes of accounting treatment, should be focused on the concept of indemnification, rather than compensation. "Indemnification" is more consistent with the concept of risk transfer than "compensation". Therefore, we believe that the US GAAP accounting definition, as currently contained in FASB Statement No. 5, better describes the insurance risk component of an insurance contract than the IFRS 4 definition.

We believe that the terms "finite insurance" or "finite reinsurance" should not be used in the context of objectives-oriented or principles-based accounting guidance. They are commonly used industry terms that have transformed over time, and thus have different meanings to different audiences.

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 insurance contracts should transfer insurance risk as required by Statement 113, paragraph 9.a. However, the requirement that an insurer be exposed to a reasonable possibility of a significant loss from each and every contract (i.e., paragraph 9.b.) is not a reasonable threshold. Even if measured across a large block of policies using present value of cash flows, this threshold is not reasonable. Expected economic results, and the variability of economic results, are widely diverse based on such factors as type of product, current market forces, and regulatory activities.

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?

We believe that bifurcation of the loss indemnity portion of an insurance or reinsurance contract does not result in more understandable and decision-useful information to the readers of financial statements. By and large, readers want financial information presented in the context of how the business is managed. The bifurcation model would create a completely different set of financial information that could not easily be analyzed in the business context. The insurance industry is viewed by financial statement users as providing loss indemnification to its policyholders. Although there may be a small group of highly sophisticated financial statement users that would effectively adapt to the proposed bifurcation of insurance contracts, we believe the large majority of users will be confused by the significant changes in the insurance industry financial statements and the necessary disclosures. Insurance and reinsurance company financial statements already contain a high level of estimation, management judgment and complexity. The bifurcation concepts introduced in the ITC would significantly increase the level of estimation, management judgment and complexity.

There exists a small population of insurance contracts for which “dollar trading” is an implicit objective. An example of this is high-deductible policies for which a substantial portion of the risk covered by the contract is effectively retained by the policyholder. The current accounting guidance already identifies such contracts as not transferring risk, and deposit accounting is required.

The current accounting model for insurance contracts is aligned with the business model. In order to faithfully represent the economic substance of the transactions, it is necessary to work within the context of the insurance market structure. Insurance contracts are generally sold as a package of services which, for property and casualty contracts, include loss indemnification, loss adjudication, loss control services, etc. Further, insurance product development and pricing activities are performed, not at the individual contract level, but for the total portfolio of risks. Bifurcation of these contracts would create artificial separation of expected cash flows that would not be consistent with product development and pricing assumptions, or more importantly how management reviews results and assesses the performance of the business.

One of the more troublesome aspects of the bifurcation model is the variation of results depending on the size of the individual contracts. For example, an insurer may sell workers compensation policies to 500 businesses each having 10 employees. That would result in “unequivocal” transfer of significant risk which does not require bifurcation. However, if that insurer also sold workers compensation policies to five businesses having 1,000 employees each, some level of the premium would be considered dollar trading and bifurcation would be required. The insurer’s aggregate exposure for the small business policies and the aggregate exposure for the large business policies could be the same. And yet in the bifurcation model the accounting results would be significantly different.

We would expect that the resulting changes to financial statements and disclosures for most policyholders would be negligible and would not justify the additional, potentially significant cost to policyholders. Except for the large insurance brokers, most insurance agents would be ill equipped to assist their policyholders with the necessary analysis to effect this change in accounting.

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?

In a bifurcation accounting model, the step, "Does the contract meet the Statement 113 risk transfer test?" is no longer relevant. The insurance component and deposit component of all contracts should be assessed under the bifurcation accounting model. In most reinsurance contracts that do not pass the Statement 113 risk transfer test, there would still be an element of risk that should be accounted for as insurance in the bifurcation accounting model.

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?

Within the context of the proposed bifurcation accounting model, we do not believe a list of the types of contracts that qualify as unequivocally transferring list is consistent with principles-based accounting guidance. The list that is presented suggests a significantly more limited population of contracts than the Required Characteristics. For example, many property catastrophe contracts for coverages above the working layer would easily meet the Required Characteristics. However, such a contract does not fit any of the described types of contracts. The Required Characteristic item (f) ("The contract is not likely to result in any claims") seems to be an unreasonably limited threshold.

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)?

The provisions of Statement of 113 and the bifurcation accounting model do not have the same objectives; therefore the "quality" of provisions between the two are not comparable. However, the characteristics described in paragraph 58 and the exemption from cash flow testing are both in the form of rules-based accounting guidance, which we believe is less desirable than a principles-based approach.

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?

Since we do not believe that bifurcation for insurance contracts and reinsurance contracts is appropriate or practical, this issue is not relevant to our response.

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

Since we do not believe that bifurcation for insurance contracts and reinsurance contracts is appropriate or practical, this issue is not relevant to our response.

However, we believe that the current accounting guidance for determining risk transfer for insurance contracts and reinsurance contracts are essentially the same, and we believe that is appropriate.

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?

Since we do not believe that bifurcation for insurance contracts and reinsurance contracts is appropriate or practical, this issue is not relevant to our response.

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?

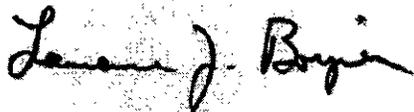
Although we have had insufficient time to consider this issue thoroughly, we believe that most of the required data exists, but the cost to extract the data and build the sophisticated modeling and accounting systems would be significant. We do not believe there would be much overlap between pricing and underwriting models and the bifurcation modeling. As stated previously, the bifurcation concept is not consistent with our marketing, pricing and underwriting framework and is foreign to our management of the business.

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?

In light of the IASB's current work on insurance contracts, it seems a more efficient approach to achieving the long-term objective of convergence in insurance accounting guidance is for FASB and IASB to work collaboratively rather than on somewhat divergent paths.

We believed, as did most of the insurance industry, that the Financial Accounting Standards Board's (FASB) current project to review accounting guidance in respect of insurance risk transfer was to result in more clarity of the current rules. We do not support a "bright line" approach to clarifying the current rules. However, expansion of representative examples and discussion of each example's risk transfer evaluation may be helpful.

Respectfully,

A handwritten signature in black ink, appearing to read "Lauren J. Boyer". The signature is written in a cursive style with a large initial "L".