



December 14, 2009

Mr. Robert Herz, Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856

Sir David Tweedie, Chairman  
International Accounting Standards Board  
30 Cannon Street, First Floor  
London, EC4M 6XH UK

Dear Chairmen:

We are writing to express our concern with the content and recommendations contained in Agenda Papers 7A and 7B prepared for the Joint FASB-IASB meeting on December 16, 2009, as they relate to the measurement and accounting for non-life insurance (“NLI”) contracts.

While paragraph 4(c) of Agenda Paper 7A indicates discussion of the use of an unearned premium reserve (“UPR”) will be discussed at a future meeting, it continues to form an integral component of the existing measurement model in use around the world for NLI contracts. We assume for purposes of this letter, that consistent with the IASB’s decisions to date, the UPR will continue to be used to represent the pre-claim liability for short-duration NLI contracts.

The UPR, typically the only market-based measure for a NLI contract during its life (inasmuch as it represent amounts received from independent third parties for future risk protection services) contains a margin designed to compensate insurers for the anticipated uncertainty of the ultimate cash flows at contract inception.

Gains are not recognized when NLI contracts are issued as no risk protection services have been provided. In contrast, if the insurer revises its estimate of the cost to fulfill a group of NLI contracts such that the anticipated cash outflows would exceed the aggregate UPR balance less any related deferred acquisition costs, a loss is immediately recognized in earnings.

The UPR, including the implicit margin, is released as risk protection services are provided during the policy coverage period. As UPR is earned, non-life insurers incur claims, a portion of which are not reported or paid, and thus remain outstanding at each financial reporting date. As it relates to measuring NLI contracts in the post-claim period, we have consistently expressed our opposition to the three building block approach as follows:

- **Building Block One – Probability Weighted Cash Flows (“PWCF’s”)**
  - Given the nature of post-claim liabilities associated with NLI contracts (i.e., imprecise range of potential settlement outcomes when claims are initially reported as well as when they are incurred but not reported), we believe it is wholly impractical to require the use of PWCF’s which require (as the most important input) construction of the range of all possible future settlement amounts together with an assignment of probability weights to each possible future settlement amount. GNAIE notes that it is typically not possible to reliably predict the probabilities associated with the entire range of possible settlement scenarios (which is infinite). Moreover, the probabilities cannot

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be fully tested with sufficient data before the environment changes enough to make the past data irrelevant to evaluating the current risk.

- PWCF's for NLI contracts does not currently exist nor do we believe it could be reliably produced for use in a measurement paradigm designed for financial reporting purposes. We believe this is yet another reason why there needs to be separate measurement models for life and NLI contracts. While not supporting the use of PWCF's for life insurance contracts, application in that context would be more attainable since there are limited outcomes for each contract and little variation in settlement amounts once claims are incurred or reported.

#### ○ **Building Block Two - Discounting**

GNAIE supports discounting and reflection of the time value of money where and when appropriate (i.e., where the amount and timing of cash flows is reliably determinable on an individual claim basis – consistent with the guidance in SEC Staff Accounting Bulletin No. 62). At the same time, we consider discounting in terms of the three building block proposal as the second building block of a three building block measurement paradigm where we believe building blocks one and three are not suitable to apply to NLI contracts. Accordingly, the application of building block two, independent of our issues with building blocks one and three, is not considered appropriate in terms of achieving a relevant measurement for NLI contracts. Notwithstanding the preceding, the following identifies fundamental issues associated with discounting short-tail and long-tail NLI contracts:

##### ***Short-tail NLI Contracts***

- Greatest claim uncertainty associated with two-thirds of claims that pay-out within two years; discounting would be both unreliable and not decision-useful
- Remaining one-third that pay-out primarily in years 3 and 4 are typically less uncertain, however, the impact of discounting is insignificant and does not aid financial statement users' understanding of the business

##### ***Long-tail NLI Contracts***

- For many long-tail contracts, roughly half of claims pay out in the first two years; the relatively short pay-out period makes discounting unreliable, not decision-useful, and generally un-necessary. This statement does not include lines of business such as Worker's Compensation where the timing and amount of cash outflows is reliably determinable on an individual claim basis.
- Remaining half of claims pay-out in year 3 and thereafter. These claims exhibit a high degree of variability which often makes discounting unreliable and not decision-useful

#### ○ **Building Block Three – Margins (risk & residual or composite)**

- Because the three building block proposal is largely statistical in nature the ability to quantify a relevant and reliable explicit risk margin in building block three is dependent upon the ability to reliably implement building block one (i.e., PWCF's together with associated distributions and probabilities) which we believe cannot be accomplished for NLI contracts
- In addition to the method described above that seeks to mathematically measure the variance and skew from a given probability distribution, there are some who believe an explicit risk margin can be reliably determined using a cost of capital ("CoC") approach. We believe this methodology would not be useful for a global insurance accounting standard as capital requirements are not consistent among implementing jurisdictions and that combined with differing levels of capital held by individual insurers both within and among separate implementing jurisdictions leads to a conclusion that risk margins determined based on CoC would not likely be either understandable or comparable across regulatory jurisdictions and thus would be of questionable value
- As it relates to explicit risk margins for NLI contracts, GNAIE notes the inability to calibrate explicit risk margins to a reliable, independent source, the lack of any evidence that this can be



accomplished for NLI contracts, and the absence of any agreement within the global actuarial profession as to how it could be accomplished

As a result of the preceding, we remain very concerned with Staff's continuing support for applying the three building block approach to measuring NLI post-claim reserves. Our concerns include the inability to reliably predict the probabilities associated with the entire range of possible settlement scenarios (which is infinite). We also note the information described is not currently used to manage the business, or for any other reason; as such it cannot be tested or validated to ensure it would produce measurements that are reliable, verifiable, comparable, understandable, and decision-useful.

In the light of the existence of no substantive support that the three building block approach can be successfully applied to NLI contracts and yield results that are relevant, reliable, verifiable, comparable, and decision-useful, we believe it is pre-mature for Staff to propose, and for the Boards to render its support for replacing a time tested, well functioning and well understood existing measurement methodology, with a largely statistically-based methodology that has yet to undergo any testing or validation.

In contrast to the IASB's largely statistically-based three building block proposal, we note that existing non-life post-claim reserves are determined by reference to estimates determined by actuaries that incorporate appropriate consideration of uncertainty. More specifically, actuarially determined estimates typically result from the application of historical development factors that incorporate actual historical realized variability as well as consideration of a range of possible reserve values determined using different actuarial techniques from which the amount of the post-claim reserve is selected. Because the amount of the reserve is not biased to the low end of the range of estimates, we believe that post-claim reserves as currently determined through the use of actuarial estimates incorporates uncertainty given the consideration of both historical realized variability as well as potential claim reserve outcomes applying multiple actuarial techniques.

In terms of remeasurement, it is useful to note that the existing non-life insurance model is updated each reporting period and claim reserves are remeasured each period and the positive or negative adjustment is immediately recognized in the operating statement.

Given the lack of global consensus on how the three building blocks could be implemented for NLI post-claim liabilities, we believe it would be inappropriate for the proposed accounting standard to require changes in measurement and reporting of NLI contracts in the post-claim phase that would be based on unproven theory. Moreover, while actuarial methodologies and techniques may be developed and enhanced in the future to enable implementation of a three building block approach, we believe that at least at present, there is no basis to change a globally recognized, well understood, and effectively functioning claim reserve measurement methodology.

We would welcome the opportunity to discuss this subject further with the boards and/or staff.

Sincerely,

A handwritten signature in black ink that reads "Kevin Spataro". The signature is written in a cursive, slightly slanted style.

Kevin Spataro  
Chairman, GNAIE Accounting Convergence Committee

KAS:cII