

**GNAIE LETTERHEAD**  
**DRAFT – FOR DISCUSSION PURPOSES ONLY**

August 13, 2010

Sir David Tweedie  
Chairman, International Accounting Standards Board  
30 Cannon Street  
London, EC4M6XH  
United Kingdom

Re: ED/2010/8 Insurance Contracts

Dear Sir David:

The Group of North American Insurance Enterprises (“GNAIE”) would like to provide initial comments to the International Accounting Standards Board (“Board”) on the Premium Allocation Approach (“PAA”) that would be applied to certain short duration insurance contracts as described in paragraphs 54 to 60 of the Insurance Contracts Exposure Draft (“ED”).

GNAIE believes the original intent of the PAA was to provide an alternative measurement paradigm (“AMP”) for certain short duration property-casualty insurance contracts whose underlying attributes are best accounted for using a short term revenue and expense model, similar to that currently in use around the world, supplemented with claim development tables as required disclosures.

In contrast to a simplified model, the PAA proposed in the ED is excessively complex and ultimately results in a full, but indirect, application of the Board’s building blocks model to both the pre-claims liability (“PCL”) and post-claim reserves (“PCR”) associated with short duration property-casualty insurance contracts. Key elements of the PAA include:

- Measurement of the PCL as the pre-claims obligation (“PCO”) **less** the expected present value of future premiums, if any, within the boundary of the existing contract;
- Measurement of the PCO as the premium, if any, received at initial recognition, **plus** the expected present value of future premiums, if any, within the boundary of the existing contract – **less** – incremental acquisition costs;
- Required discounting at current rates (i.e., rates updated each period) of both the premiums comprising the PCO and post claim reserves;
- Required application of an explicit risk adjustment to post claim reserves;
- Application of an exceptionally complex onerous contract test; which at every reporting period requires computation of the present value of the fulfillment cash flows (“PVFCF”) relating to future insured claims within the boundary of an existing contract using the full building blocks methodology. If the PVFCF exceeds the PCO, the insurer shall recognize an additional liability and a corresponding expense for the difference;
- Measurement of the claims liability at the PVFCF in accordance with paragraphs 22-46; and
- A more traditional property/casualty presentation, however, the PCL is presented on the balance sheet net of incremental acquisition costs which leads to issues with the measurement of written premiums; a primary performance metric

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GNAIE has the following concerns with the IASB's PAA:

- PAA is unsuitable for most property-casualty (i.e., non-life) contracts in that it requires a continuous application of the BB approach which was designed for life insurance contracts and does not result in relevant, reliable, comparable, transparent and understandable accounting and reporting for non-life contracts;
- The benefit of mandatory discounting of future premiums arising within insurance contracts with a coverage period of approximately one year or less does not exceed any reasonable cost-benefit threshold;
- The requirement to apply an explicit risk margin based on the “amount the insurer would rationally pay to be relieved of the risk that the ultimate cash flows exceed those expected” both in the pre and post-claims period introduces a transfer or exit (i.e., disposition ) based objective to the measurement of short duration non-life insurance contracts. In the absence of markets to which “the maximum amount the insurer would rationally pay to be relieved” can be calibrated, the risk adjustment is simply a hypothetical calculation that can be arbitrarily set by individual insurers and therefore lacks relevance, reliability, comparability and transparency. Moreover, the requirement for an explicit risk margin reflecting the hypothetical price the insurer would pay to be relieved (i.e., dispose) of the liability renders it a transfer or exit based measure (a basic element in the IASB's Preliminary Views on Insurance Contracts issued in May of 2007 that was soundly rejected by respondents due to the absence of markets or other market observable data to which explicit risk margins could be calibrated) and not a fulfillment based measure as described in the ED;
- Measurement of the claims liability at the PVFCF in accordance with paragraphs 22-46 requires “an explicit, unbiased and probability-weighted estimate of the future cash outflows less the future cash inflows that will arise as the insurer fulfills the insurance contract”. GNAIE does not support the use of probability-weighted cash flows (“PWCFs”) due to the nature non-life insurance contracts (i.e., the infinite range of potential settlement outcomes when claims are initially reported as well as when they are incurred but not reported). PWCFs require constructing the range of all possible future settlement amounts together with an assignment of probability weights to each possible future settlement amount. We believe it is not possible to reliably predict the probabilities associated with the entire range of potential settlement scenarios (which is infinite) and any probabilities assigned cannot be fully tested before the environment changes enough to render past data irrelevant to estimating current risk;
- Netting incremental acquisitions costs against the UPR (as opposed to the current practice of separate presentation) is problematic as premium is a primary performance metric and measuring premiums net of acquisition costs could destroy comparability across the industry

In contrast to the IASB's PAA, GNAIE proposes an AMP for short duration property-casualty contracts (See Appendix) based on the following considerations:

- The existing guidance in U.S. GAAP for distinguishing between short and long-duration contracts (i.e., 944-20-15-7 and 944-20-15-10) should be retained as there have historically been no issues with its application;
- Short duration property-casualty insurance contracts are fundamentally different from life insurance contracts. Moreover, the IASB's BB model was specifically designed for life insurance contracts where the investment component is an important element whereas for property-casualty contracts it is not;

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- The results from typical short-duration property-casualty insurance contracts are, by comparison to typical life insurance contracts, more uncertain and volatile. For typical property-casualty contracts we do not know if there will be a loss, when a loss may occur, or the amount of any loss. By comparison, for a traditional life insurance contract the unknowns are when the insured will die, if it will happen before the contract expires and whether the policy will lapse;
- Because claims and claims expenses are the most significant variable element of underwriting profit or loss; the incorporation of claim development tables provides a useful tool for analysts and investors to evaluate the precision of management’s reserve estimates and the corresponding quality of earnings;
- For most short duration property-casualty insurance contracts, when losses do occur, they emerge quickly (i.e., the majority are reported during the coverage period) although not as quickly as for life coverage; and
- Short duration property-casualty insurance contracts are best accounted for using a short term revenue and expense model supplemented, such as under US GAAP, with claim development tables as required disclosures.

Our understanding is the Board plans to continue consideration of the issues around the PAA as the Financial Accounting Standards Board moves toward completion of its Insurance Contracts Discussion Paper. GNAIE would be glad to assist the Boards in their continuing discussions and offers our AMP as a potential tool to differentiate those short duration contracts that should qualify for a simplified measurement and reporting approach from those that would be better suited to a BB approach.

We urge the Boards to give thoughtful consideration to our AMP proposal as we believe it could provide the basis to identify those contracts that would be allowed to continue use of the existing robust, highly-transparent, understandable measurement and reporting approach that has been in use around the globe for nearly a century.

Sincerely,

Kevin Spataro

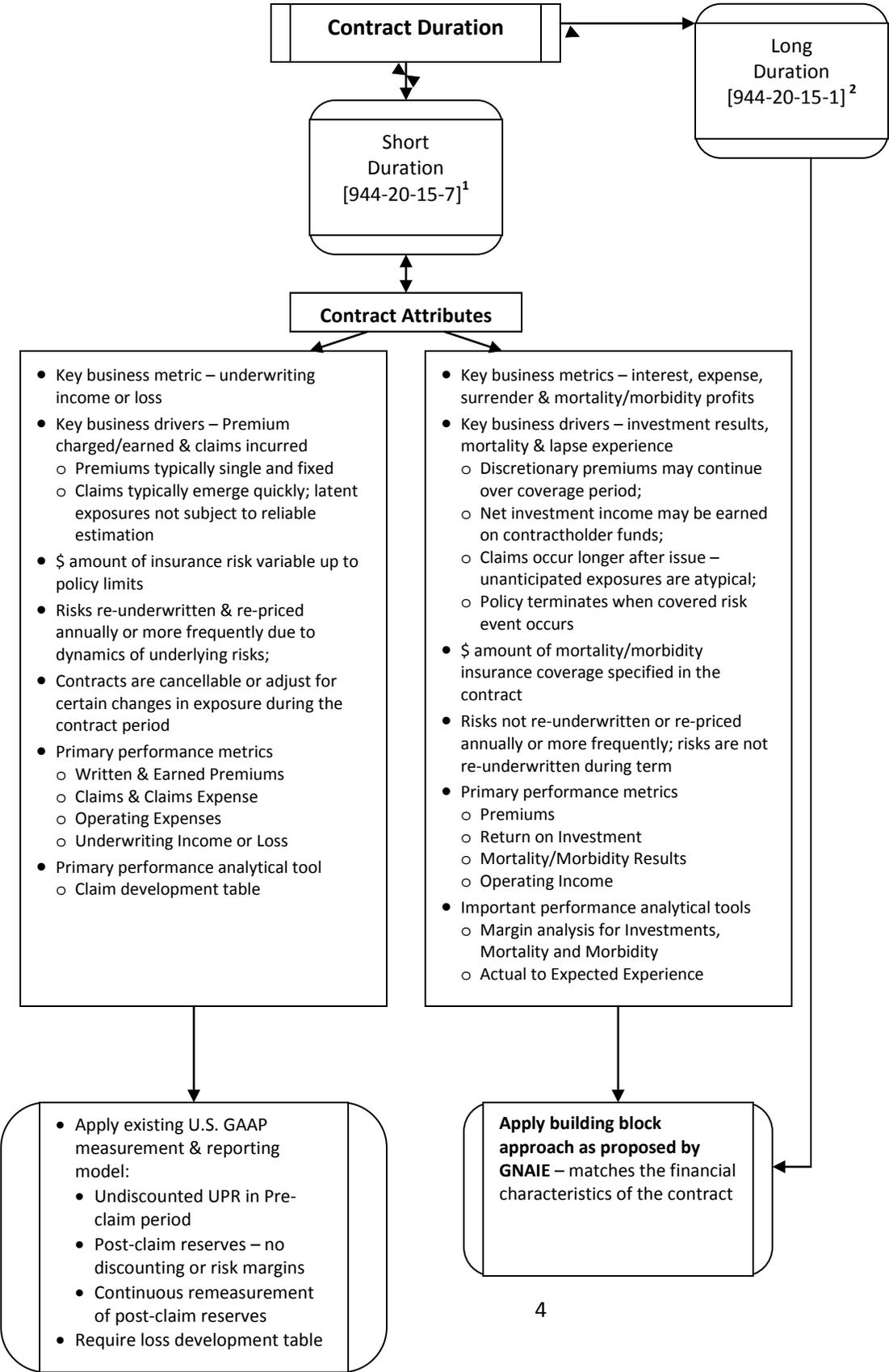
Chair, GNAIE Accounting Convergence Committee

cc: IASB Members  
FASB Members

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**APPENDIX**

**GNAIE Alternative Measurement Paradigm**



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**Footnotes**

- <sup>1</sup>: Insurance contracts shall be classified as short or long-duration contracts depending on whether they are expected to remain in force for an extended period. Factors considered in the determining whether a particular contract can be expected to remain in force for an extended period are as follows for a **short-duration** contract:
- a. The contract provides insurance protection for a fixed period of short duration.
  - b. The contract enables the insurer to cancel the contract or to adjust the provisions of the contract at the end of any contract period, such as adjusting the amount of premiums charged or coverage provided.
- <sup>2</sup>: Insurance contracts shall be classified as short or long-duration contracts depending on whether they are expected to remain in force for an extended period. Factors considered in determining whether a particular contract can be expected to remain in force for an extended period are as follows for a **long-duration** contract:
- a. Contract generally not subject to unilateral changes, such as a noncancelable or guaranteed renewable contract.
  - b. Contract requires performance of various functions and services (including insurance protection) for extended period.