



November 30, 2010

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Re: File Reference No. 1870-100: *Preliminary Views on Insurance Contracts Discussion Paper*

GNAIE (The Group of North American Insurance Enterprises, “we”) was (were) formed in 2003 to assist North American and global standard setters and regulators in support of high quality insurance accounting standards. In large part, GNAIE was formed because of the IASB’s project to develop an international financial reporting standard for insurance contracts. Over the last seven years, we have interacted extensively with the IASB, the FASB, and many other standard setting, regulatory and insurance industry bodies around the world to share ideas about financial reporting for insurance contracts. We support development of converged international standards that are useful, understandable, comparable, and reliable, that provide a level playing field for the insurance industry in global capital markets, and that include relevant disclosures to the insurance industry’s diverse constituencies.

We are pleased to provide our comments on the FASB’s Discussion Paper, “Preliminary Views on Insurance Contracts”, (the “DP”) (File Reference No. 1870-100). We do not support several of the preliminary views in the DP in their current form. We would like to highlight two key issues in this letter before responding to the specific questions in the DP, where we discuss our concerns in detail.

1) Different measurement models are needed for life and non-life insurance contracts.

The general accounting and reporting model in place globally for non-life insurance contracts recognizes all revenues and expenses on a gross, undiscounted basis during the coverage period. While the accounting and reporting model for non-life insurance recognizes all revenue during the coverage period, it also recognizes all anticipated expenses, including the gross cost of settling claims beyond the coverage period. The absence of discounting provides symmetry in the recognition of revenues and expenses during the coverage period. In addition, the absence of risk margins is attributable to the fact that (a) there exists no empirical evidence to suggest they can be reliably determined in a manner to support comparability between insurers, and (b) management’s ability to adequately establish reserve estimates can be evaluated in a more objective, reliable, and comparable manner through the use of properly constructed claim development tables.

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The business models for life and non-life insurers are fundamentally different. For example, non-life insurers focus their attention on underwriting results, which excludes investment income; whereas, life insurers focus their attention on investment income, mortality and morbidity results, and the level of expenses and surrenders. As a result, it is necessary to provide separate responses in this letter for non-life insurance and life insurance for many of the questions in the DP. The aforementioned unique business models are the result of significantly different characteristics of non-life and life insurance contracts which ultimately lead to significantly different considerations for many of the issues covered in the DP. Therefore, using a single model for measuring all of the contracts that meet the definition of insurance in the DP is not appropriate.

Life insurance contracts are typically of long duration and pay a fixed benefit to compensate beneficiaries for a covered loss. There can only be one insured loss. A key element in pricing long duration life insurance contracts is the investment income expected to be earned on assets the insurer holds to back its liabilities under these contracts. There are certain types of contracts that meet the definition of an insurance contract in Paragraph 22 of the DP, that are not life insurance, but that clearly are long duration contracts for which matching assets and liabilities is a key element of the business model (e.g., long term care insurance and insurance guaranteeing the performance of long duration bonds). For purposes of the discussion in this letter, these contracts should be treated as life insurance contracts rather than as non-life insurance contracts.

In contrast, non-life insurance contracts are typically of short duration and pay indemnification benefits only to indemnify contract holders who suffer covered losses. There may be any number of covered losses during the coverage period and the amounts that will be paid to indemnify those contract holders for their losses, as well as the timing of when the payments will be made, is unknown and restricted only by actual amount of loss suffered and the contract benefit limits. Due to the uncertainties of payment amounts and timing, and the short duration of most non-life insurance contracts, the investment income expected to be earned on assets the insurer holds is not a key consideration in the pricing of these contracts.

The unique attributes of non-life insurance require different approaches for: pre-claim liability measurement, post claim liability measurement, the use of discounting, application of margins, profit recognition timing, contract recognition, balance sheet presentation, and income statement presentation among others. These issues are discussed in more detail throughout our responses below to the questions posed in the DP.

While the building blocks measurement model proposed in the DP is generally appropriate for life insurance contracts, several changes are needed to make the proposed model relevant and representationally faithful for life insurance. At the same time, the building blocks model is not appropriate for non-life insurance contracts in that it would not provide measurements that are representationally faithful and relevant to the non-life insurance business model. Furthermore, the Premium Allocation Approach (PAA) proposed in the IASB's Exposure Draft (ED) is neither a simplification nor an approach that would be an improvement relative to the existing model for measuring and presenting financial results for non-life insurance contracts currently used in most of the world.



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Insurance regulators in many countries, including the U.S., require separate legal entities to write life insurance and non-life insurance contracts. Regulatory risk assessment and capital requirements are different, and different regulatory and performance statements and supporting schedules are required for life and non-life insurance.

There is strong support for greater consistency in life insurance financial reporting. In contrast, the current financial reporting model for non-life insurance contracts is significantly more transparent, and it is very well understood and useful; therefore it does not need substantial revision. We believe that further field testing of the measurement proposed in the IASB's ED will reveal that the results of those proposals will be significantly less transparent and less decision-useful for non-life insurance contracts.

We do not support using the expected present value of the future cash inflows less future cash outflows to measure most non-life insurance contracts, because the impact of the time value of money is typically not significant and not reliably determinable. Therefore it would have the effect of decreasing the understandability and usefulness of information about periodic reserve changes. In contrast, nominal (i.e., undiscounted) reserves are much more understandable, especially when supported by appropriately designed claim development tables. Nominal reserves supplemented by such claim development tables provide the most transparent (i.e., understandable) and decision useful information to financial statement users/investors about periodic reserve changes, the most critical performance metric for non-life insurers.

We support the discounting of claim reserves where cash flows are fixed and determinable on an individual claim basis (e.g., workers' compensation claims). This position is consistent with current U.S. GAAP, which provides in the Securities and Exchange Commission's Staff Accounting Bulletin (SAB) Topic 5N that "discounting would be appropriate when the payment pattern and ultimate costs are fixed and determinable on an individual claim basis."

The financial reporting model we support for non-life insurance contracts is described in detail in our responses below to the questions in the DP.

2) The inter-relationships between reporting standards for insurance contracts and financial instruments must be considered and reflected in both standards.

The IASB issued its standard on classification and measurement of financial instruments (IFRS 9) in November 2009 without considering the business model of entities writing insurance contracts. The IASB has indicated that it does not intend to revisit the decisions it reached in moving to finalize this standard. A fundamental challenge in developing standards that will result in financial reporting for insurance entities that is relevant and representationally faithful is that most liabilities for these entities will be measured according to one standard and most assets for these entities will be measured according to a different standard.



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If these projects are to provide financial reporting for insurance companies that is relevant and that represents faithfully the economic results of these companies, it is critical that the Boards provide for consistent reporting of assets and liabilities in the financial statements of these companies. The standards on financial instruments and insurance contracts should become effective in consistent time frames; and before these standards come into effect, the Boards should redeliberate to make sure that the standards provide for consistent reporting of assets and liabilities that will react similarly to significant changes in economic conditions.

For example, the business model for life insurance contracts is heavily based on the matching of assets and liabilities. If the values of assets and liabilities of life insurance companies move in significantly different directions and magnitudes, and react very differently to changes in economic conditions, the financial statements of these companies will be subject to non-economic mismatches (i.e., wide swings that are inconsistent with economic values).

The discount rate basis to be used in measuring the present value of life insurance cash flows continues to be one of the most contentious issues in the DP. It is also an issue that is most critical to the relevance and representational faithfulness of the measurement model, in view of the long duration of life insurance contracts and the central role of asset liability matching in the business model for such contracts. We recommend that the Boards seek advice from an expert panel drawn from the global insurance industry, both with respect to how an appropriate discount rate should be determined and with respect to which liabilities should be discounted.



Definition and scope

1) Are the proposed definitions of *insurance contract* and *insurance risk* (including the related guidance) understandable and operational?

Response with Respect to Non-Life and Life Insurance

Further clarification should be provided in the definition and related guidance that insurance contracts can “compensate” and/or “indemnify” for insured losses. We do not agree with the contention that these two terms have broadly the same meaning. Benefits paid according to some insurance contracts (e.g., life insurance) compensate the beneficiary for an insured loss, which provide a payment that cannot put the insured or the beneficiary in the same position they were in before the loss. Benefits paid according to other insurance contracts (e.g., property insurance) indemnify the policyholder for an insured loss, and are intended to put the policyholder as nearly as possible in the same position that he/she was in prior to the loss. The definition should provide clearly for both types of benefits. This is yet another example of why two models are needed to reflect the differences between life and non-life insurance contracts.

2) If the scope of the proposed guidance on insurance contracts is based on the definition of an insurance contract rather than on the type of entity issuing the contract, would financial reporting be improved?

Response with Respect to Non-Life and Life Insurance

Yes. This change would provide for consistent financial reporting of contracts that have the same characteristics, regardless of the entity that issues such contracts. As described more fully in our responses to other questions in the DP, all insurance contracts do not have similar characteristics, and different financial reporting models are needed for life and non-life insurance contracts, based on substantially different characteristics of such contracts (e.g., life insurance contracts typically provide for a stated amount benefit that can be paid at most one time, while non-life insurance contracts typically provide indemnification for a loss that is of unknown amount (subject to policy limits), and that may never occur or may occur once or multiple times during the coverage period).

3) Do you agree with the proposed scope exclusions? Why or why not?

Response with Respect to Non-Life and Life Insurance

Yes. We agree with the scope exclusions that are listed in Paragraph 28 of the DP.



4) Should benefits that an employer provides to its employees that otherwise meet the definition of an insurance contract be within the scope of the proposed guidance? Why or why not?

Response with Respect to Non-Life and Life Insurance

This is a subject that requires further study before a conclusion is reached on whether to include some or all of such benefit arrangements within the scope of the proposed guidance.

5) The Board's preliminary view is that participating investment contracts should not be accounted for within the proposed model for insurance contracts but, rather, should be included in the scope of the proposed model for accounting for financial instruments. Do you agree? Why or why not?

Response with Respect to Non-Life and Life Insurance

Yes. We agree with the Board's preliminary view that such contracts should be included in the scope of the proposed model for financial instruments, and not within the proposed model for insurance contracts. By definition, these are not insurance contracts. Proponents of including them within the scope of the proposed insurance contract standard argue that: 1) they are within the scope of IFRS 4; and 2) such contracts are supported by a pool of assets that is also used to support insurance contracts. These reasons do not justify including non-insurance contracts within the scope of the proposed insurance contracts standard. These investment contracts should be in the scope of the financial instruments standard.

6) Do you support the approach for determining when non-insurance components of contracts should be unbundled? Why or why not?

Response with Respect to Life Insurance

We agree with the principle in Paragraph 39, whereby "if a component is not closely related to the insurance coverage specified in a contract, an insurer would account for that component as if it were a separate contract and apply the relevant standard to that component". Conversely, components of a contract that are closely related to the insurance coverage specified in the contract should not be separated (unbundled). However, we are concerned that the examples provided in Paragraph 40 may imply unbundling of some components that are closely related to the insurance coverage. In particular, some insurance contracts include policyholder account balances (e.g., some universal life contracts) that provide for crediting explicit returns on those balances that are closely tied to asset returns, but with discretion retained by the insurer regarding the amount and timing of the credited return. The example in paragraph 40.a. may provide for bundling of some such contracts and unbundling of others that are substantially the same. It is often not clear whether or not the amounts that are credited to policyholders include all investment performance of a particular or notional pool of assets, net of contract fees and assessments.



Recognition and measurement

7) Do you agree with the use of the probability-weighted estimate of net cash flows to measure insurance contracts? Does that approach faithfully represent the economics of insurance contracts? Is it an improvement over existing U.S. GAAP?

Response with Respect to Non-Life Insurance

Our response to all three questions is “no” for non-life insurance contracts. The financial reporting standard should not require, or imply the need for, a probability weighted methodology to estimate cash flows to measure non-life insurance contracts. It is not possible to reliably estimate the probabilities associated with the entire range of potential settlement scenarios (which is infinite), and any probabilities that are assigned cannot be fully tested before the environment changes enough to render the past data irrelevant to estimating the current risk.

The financial reporting standard should instead set forth basic principles, and should allow the actuarial profession to set the standards for how those principles will be applied. For example, if the intent is that the estimated cash flows should represent the mean outcome, then the financial reporting standard should explicitly state this principle and leave it to the actuarial profession to determine the methods or approaches that should be used to meet this criterion. In principle, the result of many of the actuarial techniques in use around the world today could be considered estimates of the mean expected cash flows adjusted for uncertainty.

In estimating cash outflows related to non-life insurance claims liabilities, we support the current approach based on rigorously developed actuarial estimates supplemented by appropriately constructed loss development schedules which objectively demonstrate the accuracy of actuarially determined estimates over time. Using probability-weighted cash flows does not faithfully represent the economics of contract fulfillment cash flows for non-life insurance claims liabilities and would not represent an improvement over existing U.S. GAAP.

Response with Respect to Life Insurance

While we agree that estimates of net cash flows should be used to measure life insurance contracts, it is not necessary or appropriate for these to be probability weighted cash flows in many cases. The operational guidance should not require, or imply the need for, a probability weighted methodology to estimate cash flows. Instead, the financial reporting standard should set forth the basic principles that the cash flow estimates should meet, and should allow the actuarial profession to set the standards for how those principles will be applied. For example, if the intent is that the estimated cash flows should represent the mean outcome, then the financial reporting standard should explicitly state this principle and leave it to the actuarial profession to determine the methods or approaches that should be used to meet this criterion. There are different ways to develop cash flows that result in a mean outcome and there should be latitude in arriving at this result.



With this flexibility, the approach could faithfully represent the economics of life insurance contracts, and could be an improvement over current U.S. GAAP. However, prescriptive requirements in the standard for how the cash flow estimates are to be calculated would not faithfully represent the economics of some life insurance contracts, and would not be an improvement over current U.S. GAAP.

8) Do you think that an entity's estimate of the net cash flows should include a risk adjustment margin?

Response with Respect to Non-Life Insurance

A measurement model that does not include explicit margins (or discounting) in the pre-claim and claim periods continues to provide the most transparent information to investors about most non-life insurance contracts (other than those contracts for which the payment patterns and ultimate costs are fixed and determinable), when supplemented by appropriately designed claim development tables.

If the measurement model does include an explicit margin, there should not be a requirement to quantify a specific risk adjustment, and therefore the margin should be a single composite margin (as the FASB favors), for the reasons described below in our response to this question with respect to life insurance. However, if there is a composite margin, it should be recognized entirely over the coverage period, with none of it recognized over the claim payment period. Generally, the profitability of many non-life products should be known by the end of the coverage period. The short duration coverage periods for these contracts, for which losses are reported fairly quickly, allows for results of underwriting decisions (the key profit driver for non-life insurance contracts) to come to light rather quickly using nominal reserves. To arbitrarily extend the run-off of margins, which may implicitly include expected profits, over the claim paying period, does not accurately reflect the nature of the non-life insurance business and would not be decision useful.

Response with Respect to Life Insurance

No. We do not think that an entity's estimate of the net cash flows for life insurance contracts should include a risk adjustment margin, as proposed by the IASB. For life insurance contracts, we support a single composite margin and there should not be a requirement to quantify a specific risk adjustment margin separately within the composite margin.

It would be more useful to focus on the total margin available in the reserve rather than on theoretical calculations of pieces of the margin. While it is possible to define methods for assigning values to risk adjustment margins, these are theoretical calculations that have little if any practical meaning. If a user wants to understand the risk in an insurer's reserves, there are better ways to provide that information through disclosure in the notes, including actual to expected results and sensitivity calculations.



The two margin (risk adjustment plus residual margin) approach is most likely to mislead users into thinking that the information reflects precision (that does not exist in these calculations), or that the residual margin is a pure profit provision rather than what it is - an arbitrary division of the available margin that consists largely of premium intended to cover general administrative expenses and overhead not included in the first building block. We are concerned that most analysts will remove the risk adjustment margin and residual margin, and replace it with their own view of what margin is required without having the required information to do so in a proper way. The costs of theoretically calculating a risk adjustment will far outweigh any benefits. Modeling results we have seen suggests that the risk adjustment will frequently be a small piece of the total margin.

Explicit risk adjustment margins do not increase the relevance or understandability of the reported liability for a number of reasons, including the lack of any empirical support that explicit risk margins can be reliably measured, the significant practical constraints to back-testing risk adjustments, lack of comparability of risk adjustment information between insurers due to the entity specific nature of their underlying objective, and the basic inappropriateness of attempting to capture the multitude of complex risks facing insurers in a single statistically based number.

- 9) Is the objective of the risk adjustment margin understandable? If so, do you think that the techniques for estimating the risk adjustment margin (see Paragraph 52(b)), faithfully represent the maximum amount that the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected?**

Response with Respect to Non-Life and Life Insurance

The risk adjustment should not depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected. This description of the risk adjustment conflicts with the fulfillment notion, as insurance contracts generally cannot be transferred without obtaining necessary regulatory approvals, and rarely occur because such transfers would be contrary to the intent and the business purpose of insurers. Thus the proposed objective of the risk adjustment is based on cash flows that are not expected to occur. The proposed risk adjustment would impute a value for being relieved of obligations at each reporting date which would be a transfer notion, very much like the “current exit” value that was proposed as the measurement basis in the IASB’s 2007 Discussion Paper on insurance contracts, and was widely rejected by respondents.

The proposed objective of the risk adjustment is based only on the risk that the ultimate fulfillment cash flows exceed those expected (i.e., only unfavorable variation). Even on a hypothetical basis, the amount an insurer would rationally pay to be relieved of only the risk of unfavorable variations in cash flows would be substantially higher than the amount it would rationally pay to give up the risk of both favorable and unfavorable variations.



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The techniques for estimating the risk adjustment margin that are described in Paragraph 52(b) of the DP are three of the generally used methods for estimating risk. If the measurement model does include a specific risk adjustment, the financial reporting standard should not restrict the methods that can be used to calculate such adjustment; but rather should provide general principles that the risk adjustment should meet. The actuarial profession could then develop more specific guidance on how to determine the risk adjustment. No single number can faithfully represent the risk that ultimate fulfillment cash flows exceed those expected. Faithful representation of this risk can be accomplished through more complete qualitative and quantitative disclosure.

10) Do you think that the risk adjustment margin would be comparable for entities that are exposed to similar risks?

Response with Respect to Non-Life and Life Insurance

We understand that the IASB's intention in proposing to limit the estimation techniques is to force a degree of comparability among the risk adjustments reported by different entities. However, increased comparability will not result from imposing these limitations. The reported risk adjustments will still vary widely depending on the assumptions and other judgments that each entity makes.

If the financial reporting standard were to force entities to use the same or very similar assumptions and to eliminate or substantially reduce the judgments that entities could apply, the results would not faithfully represent the risks that each entity faces. The financial reporting standard should provide general principles that the risk adjustment should meet, and the actuarial profession could then develop more specific guidance on how to determine the risk adjustment. Faithful representation of risks can be accomplished through more complete qualitative and quantitative disclosure.

11) Do you agree with the description of cash flows that should be included in the measurement of an insurance contract? Is the proposed guidance operational?

Response with Respect to Non-Life Insurance

As described more fully at the beginning of this letter, we do not support a building block measurement model for non-life insurance contracts. We do not object specifically to the description of cash flows in Paragraph 56; but we do object to proposals and guidance for cash flow estimates elsewhere in the DP. The financial reporting standard should not require, or imply the need for, a probability weighted methodology to estimate cash flows of non-life insurance contracts. It is not possible to reliably estimate the probabilities associated with the entire range of potential settlement scenarios (which is infinite), and any probabilities that are assigned cannot be fully tested before the environment changes enough to render the past data irrelevant to estimating the current risk.



The financial reporting standard should set forth basic principles for the measurement, and should allow the actuarial profession to set the standards for how those principles will be applied. If the intent is that the estimated cash flows represent the mean outcome, then the financial reporting standard should explicitly state this principle and leave it to the actuarial profession to determine the methods or approaches that should be used to meet this criterion. In principle, the result of many of the actuarial techniques in use around the world today could be considered estimates of the mean expected cash flows adjusted for uncertainty.

Response with Respect to Life Insurance

Yes. For life insurance contracts, we agree with the description in Paragraph 56 of cash flows that should be included. Specifically, we agree that the cash flows that should be included must be within the boundary of existing contracts and incremental at the level of a portfolio of contracts; and that the cash outflows should include direct costs and systematic allocations of costs that relate directly to the insurance contracts or contract activities. However, as discussed more fully in our response to Question 14 below, the acquisition costs that should be included are those that are incremental at a portfolio level rather than individual contract level.

The operational guidance should not require, or imply the need for, a probability weighted methodology to estimate cash flows. The financial reporting standard should set forth the basic principles that the cash flow estimates should meet, and should allow the actuarial profession to set the standards for how those principles will be applied. For example, if the intent is that the estimated cash flows should represent the mean outcome, then the financial reporting standard should explicitly state this principle and leave it to the actuarial profession to determine the methods or approaches that should be used to meet this criterion. There are different ways to develop cash flows that result in a mean outcome and there should be latitude in arriving at this result.

12) Do you agree that the carrying amount of all insurance contracts should be discounted if the effect is material? Do you agree with the proposed guidance on the discount rate that should be used to measure the carrying amount of insurance contracts? If not, which discount rate should be used?

Response with Respect to Non-Life Insurance

A measurement model that does not include discounting (or explicit margins) in the pre-claim and claim period continues to provide the most transparent information to investors about most non-life insurance contracts, when supplemented by appropriately designed claim development tables. The use of claim development schedules showing actual historical experience (which is a current U.S. regulatory requirement) provides a better indication of the uncertainty of the liability and allows users to make such determinations themselves.



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For non-life insurance contracts, discounting should only apply to payment liabilities that are fixed and determinable on an individual claim basis (e.g., workers' compensation claims). In other words, we support discounting insurance reserves for long-duration contracts that meet the condition outlined in the Securities and Exchange Commission's Staff Accounting Bulletin (SAB) Topic 5N, which provides that "discounting would be appropriate when the payment pattern and ultimate costs are fixed and determinable on an individual claim basis."

Investors and other users of financial statements of non-life insurers are keenly aware of the significant implications of under-reserving claim liabilities. Inadequate loss reserving is the leading cause of non-life insurer insolvencies in the United States. Under-reserving of claim liabilities leads to subsequent losses when higher payments are actually made. In addition, to the extent that inadequate estimates of loss experience are considered in pricing decisions for future non-life insurance contracts, it may lead to inadequate pricing and subsequent losses for those future contracts as well. While the time value of money cannot be denied, it is more valuable to financial statement users to focus on the most transparent view of management's ability to adequately assess and measure claim liabilities. Discounting non-life insurance claim reserves would detract from that focus.

The business model and the economic substance of short-duration non-life insurance contracts, in particular, would be misrepresented if discounting is required for these contracts liabilities. The business model for lines of insurance such as auto and homeowners insurance is to underwrite (i.e. properly differentiate, classify and price risk) and manage portfolios of insurance risks with the objective of producing an underwriting profit, exclusive of interest income, and managing cash flows in a manner that allows claims to be settled as they arise pursuant to the terms of the underlying contracts. The introduction of discounting would impair the ability of investors and other financial users to assess the underwriting performance of insurers, and the insurers' ability to estimate claims reserves accurately.

Response with Respect to Life Insurance

We know that the discount rate basis to be used in measuring the present value of life insurance cash flows continues to be one of the most contentious issues in the DP. As stated previously in this letter, we recommend that the Boards seek advice from an expert panel drawn from the global insurance industry, both with respect to how an appropriate discount rate should be determined and with respect to which liabilities should be discounted.

In our view, the discount rate should not be delinked from the assets backing the liability. Ignoring the assets that back the liability is a flawed approach that will result in inaccurate measurement of the entity, noneconomic earnings and surplus volatility, and, as a result, is in contradiction with the IFRS Conceptual Framework. The IFRS Conceptual Framework requires a measure of the financial position of the entity which both (a) includes the impact of all transactions entered into by the entity and (b) is a complete measure of all phenomena associated with those transactions. When an insurer issues an insurance contract, it embarks on a series of transactions that are intended to fulfill the insurer's obligations under the contract. One phenomenon associated with those transactions is cash flow mismatch risk – the risk that the



assets purchased by the insurer with the premium inflows will produce cash inflows at times or in amounts that are different than the times or amounts necessary to fulfill the contract. The proposed discount rate does not measure any cash flow mismatch at inception (because the asset cash flows are not considered in the measurement of the insurance contract). In subsequent periods, the change in the cash flow mismatch is only indirectly measured, which contributes to the volatility mentioned elsewhere in this response.

A significant portion of the policy liabilities of North American life insurers consists of long-term illiquid contracts. (Long term in this context means at least ten years; but liability cash flows can extend over 40 or more years.) These contracts have been priced using a number of assumptions, including assumptions about how the premiums will be invested and grow before being required to fund policy outflows. In order to minimize economic risk, the practice of insurers is to build a portfolio of assets, from which the cash inflows match the expected cash outflows of insurance contracts, increased by margins for adverse deviation.

The essence of the life insurance business model is to manage assets and liabilities in an integrated fashion, pursuant to a model that could be described as analogous to a replicating portfolio or analogous to hedging the liability cash flows. The primary aim is to match future policy liability cash flows, including risk margins, with net realizable future asset cash flows. Although the business model strives for accurate cash flow matching, full matching is never achieved because a true replicating portfolio does not exist. It is impossible to match liability cash flows that are projected to occur past the horizon for which there exists a sufficiently deep market for fixed income assets. In addition, mismatches can result from management taking a certain view on economic trends, such as the future movement of interest rates. Whether economic mismatch arises from imperfect or non-existent opportunities for matching or from other reasons, it is an integral and indispensable component of the economic returns eventually realized by the insurer.

Given this business model, an appropriate measurement model should clearly measure economic asset liability mismatch. The discount rate proposed in the DP may, and often will, give rise to accounting (non-economic) mismatches for the following reasons:

1. Separate and inconsistent measurement of assets and liabilities fails to take account of the business model.

The FASB and IASB have recognized the importance of consistency of the accounting model with the business model. They have also espoused the objective for the accounting model to reflect economic mismatch while avoiding accounting mismatch as far as possible. It is appropriate to recognize the business model of long duration life insurance. However, the guidance in the DP imposes inconsistent measures on the two sides of the balance sheet, resulting of necessity in accounting mismatch and inappropriate measurement and volatility of net assets (accounting capital and surplus).



2. The proposed model fails to measure the cash flow mismatch risk associated with different investment strategies.
This risk is an integral part of the business model for insurers. The discount rate guidance in the DP will not measure any mismatch at inception. An insurer that invests premiums in cash will have the same initial measurement, and financial position, as an insurer that invests premiums in corporate bonds. Clearly these investment decisions are very different economically; yet there is no reflection of this difference in the values measured at inception.
3. Measurement of liabilities would be inconsistent with measurement of assets.
However the liquidity adjustment is measured, there can be no doubt that the measurement of insurance contract liabilities will be inconsistent with the measurement of the supporting assets, even when the cash flows are near-perfectly matched. The DP does not offer guidance on how to determine an adjustment for liquidity. No method for so doing is prescribed on the reasonable grounds that no consensus exists on how to do so; yet this obligation would be imposed on preparers. This will lead to differences of interpretation and lack of comparability. Consequently, we are concerned that the reliability of the measurement of long duration insurance contracts will be suspect and users will be hard pressed to understand the financial statements. The consequence is inevitable accounting mismatch.
4. The measurement proposed does not address very long duration liability cash flows.
The extension of the yield curve to points beyond which deep and liquid markets for assets exist is not important for short duration businesses; but it is of critical importance for life insurers, much of whose business is very long duration. Any notional extension of the current yield curve that in essence projects an extension of the current term structure introduces unwarranted volatility in the measure, since the discounted value of unmatchable cash flows is highly sensitive to changes in the discount rate. Once again, such volatility is spurious in that current interest rates are irrelevant in predicting yields 20 or more years into the future. We propose that the discount rate for time periods beyond what is currently matchable should be based on a long-term moving average, so that it would respond to major and enduring trends but not to momentary yield curve volatility, a concept that we understand CEIOPS is also espousing.

Using an asset discount rate that is based on the assets currently backing the liabilities would address these problems.



13) Do you think that acquisition costs should be included as one of the cash flows relating to the contract? If not, how would you account for acquisition costs?

Response with Respect to Non-Life and Life Insurance

Yes. We agree that acquisition costs should be included as one of the cash flows relating to the contract.

14) Do you agree that acquisition costs included in the cash flows used in the measurement of the insurance contract should be limited to those that are incremental at the individual contract level? If not, which acquisition costs, if any, would you include in the measurement of the insurance contract?

Response with Respect to Non-Life and Life Insurance

We agree that incremental acquisition costs should be included in initial measurement of insurance contracts as contract cash outflows, for insurance liabilities that are measured according to the building block approach. However, the acquisition costs that are included should be incremental to the insurer at the portfolio level (rather than at the level of individual insurance contracts, as proposed in Paragraph 59 of the DP). Thus, for example, we would include in the initial measurement as contract cash outflows costs of the insurer's underwriting process (those necessary for acquisition of insurance contracts) that are incremental for a portfolio of insurance contracts.

Limiting the acquisition costs to be included in the initial measurement to those that are incremental at the individual contract level would discriminate among insurers based on the forms of distribution that they use. Measurement on this basis would lead to different reported liability values based on how the contracts were distributed, even if the form of distribution has no effect on the expected future cash flows or on the obligations of the insurer. Forms of distribution commonly used by insurers include distribution by independent brokers, by employees or agents who are not independent, and by direct marketing (such as over the internet). Each form of distribution has different mixes of acquisition costs that are incremental at the contract level and incremental at the portfolio level.

The guidance recently issued by the FASB in ASU 2010-26 (Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts) provides a reasonable basis for determining the acquisition costs that could be included in the initial measurement. This U.S. GAAP guidance generally would not discriminate among insurers on the basis of the form(s) of distribution they use, when the guidance in ASU 2010-26 is considered along with guidance in U.S. GAAP for direct marketing expenses (Topic 340-20). Because the distribution and organization forms differ among insurance companies, U.S. GAAP also allows insurers to immediately expense acquisition costs, even though such expenses could be eligible for deferral. Insurance companies may decide to immediately expense certain acquisition costs based on cost/benefit analyses.



15) Do you agree with the use of either the composite margin approach or two-margin approach to measure the net insurance contract? Does either approach faithfully represent the economics of insurance contracts? Is either approach an improvement over the measurement used in current U.S. GAAP?

Response with Respect to Non-Life Insurance

Introducing any type of explicit margin would not produce measurements that are more relevant, understandable, or comparable than current U.S. GAAP with respect to non-life insurance contracts, for a variety of reasons.

- 1) There is no empirical support that such margins can be reliably measured.
- 2) There are significant practical constraints to back-testing.
- 3) Investors will not be able to adequately compare margins between insurers, due to their entity specific nature, and the basic inappropriateness of attempting to capture a multitude of complex risks facing insurers in a single statistically based number.

In contrast, the claim reserve estimation process in place globally to support the measurement of claim reserves for general purpose reporting relies on well developed, time-tested actuarial methods, models, and judgments that are extensively described in the notes to the financial statements and other supporting descriptions. We strongly believe that the existing processes in place around the world have already achieved the desired result of reporting claim reserves that are appropriately estimated to reflect management's best estimate of the actual amount it expects to settle claims with policyholders pursuant to the contractual terms of the underlying insurance policies. These estimates, the reliability of which is substantiated by appropriately designed claim development tables, would not be enhanced by the introduction of either or both discounting or explicit margins, which would impair both the understandability and comparability of the reported information.

To address investors needs for information about the inherent risks recorded in the claim reserves, we would point to (a) the comprehensive discussion of the reserving process provided within the Critical Accounting Estimates combined with relevant forward looking disclosures provided in Management's Discussion and Analysis, as required by the Securities and Exchange Commission; and (b) U.S. Statutory Schedule P, which provides rich loss development data by line of business and accident year.

We also have a specific concern that the residual margin in the two-margin approach will be considered a deferred profit and will be treated as capital for EU solvency measures. This treatment would contradict the proposal for no gain at inception that is in both the DP and the IASB's ED.



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Response with Respect to Life Insurance

For life insurance contracts, we support the composite margin approach and we do not support the two margin approach. The reasons for these positions are explained in detail in our response above to Question 8. We think that the composite margin approach would faithfully represent the economics of life insurance contracts, and would be an improvement over the measurement used in current U.S. GAAP, if applied together with the other suggestions we make in this letter with respect to measurement of life insurance contract liabilities.

16) Do you think that the composite margin should be recognized in earnings in subsequent periods using the ratio described in Paragraph 83? If not, how would you recognize the composite margin in earnings?

Response with Respect to Non-Life Insurance

The measurement model for non-life insurance contracts should not include an explicit margin, for the reasons describe at the beginning of this letter. However, if the measurement model does include a margin, any such margin should be recognized in earnings over the contract coverage period, as the insurer is released from insurance risk. Profit should not be deferred and recognized over the claim settlement period, as settling claims is a purely administrative service and is not representative of the provision of insurance protection, which is only provided during the contractual coverage period. The business model of non-life insurers is to underwrite and manage portfolios of insurance risks with the objective of producing underwriting profits.

Response with Respect to Life Insurance

No. The guidance should not specify a particular method or formula for release of the composite margin. Instead, general guidance and/or examples should be included to describe how the reporting entity should run-off the margin in a way that is consistent with release from insurance risk. The composite margin should be released over the coverage period, which would be consistent with release from insurance risk. The insurer should disclose the basic parameters for how it calculated the margin and how the margin is released. But due to the diversity of product types and risk factors, a single method should not be applied for all contracts.

17) Do you agree that interest should not be accreted on the composite margin? Why or why not?

Response with Respect to Non-Life and Life Insurance

Yes. We fully agree that interest should not be accreted on the composite (or residual) margin, if such margin is included in the measurement model. Accreting interest on these margins would add complexity to the liability measurement with little or no benefit in the information about margins that is conveyed to users of financial statements.



18) Do you think that all insurance contracts should be recognized and measured using one approach or that some insurance contracts should be recognized and measured using an alternative approach (for example, the modified approach)? Why or why not?

Response with Respect to Non-Life Insurance

The unique attributes of life and non-life insurance contracts (e.g., life insurance contracts are typically long-duration whereas non-life are typically short-duration, a known versus unknown benefit/claim amount for life versus non-life, the number of times a benefit/claim may be paid under a single contract) require separate accounting measurement, presentation, and disclosure models. A more simplified measurement approach should be applied for non-life insurance contracts as a separate model (for both pre-claim and claim liabilities). This simplified measurement approach would be consistent with the general practices currently in place in most of the world. We describe this measurement approach in more detail in the beginning section of this letter.

19) If an alternative approach is required for some insurance contracts, what recognition, measurement, and presentation provisions should be applied (including those items noted in Paragraph 106)?

Response with Respect to Non-Life Insurance

For non-life contracts, we support the use of the Unearned Premium Reserve (UPR) approach that is common in accounting standards worldwide. More specifically, insurance premiums received prior to the inception of the contract should be reported as Advance Premium. Then, at the inception of the contract, any Advance Premium plus the remaining premium for the contract term, whether collected on not, would be reclassified to UPR, which would be earned on a pro-rata basis over the coverage period consistent with the provision of insurance risk protection.

Claims and related claims expenses would be measured on a nominal (i.e., undiscounted) basis, and appropriately designed claim development tables would be constructed and presented to allow investors and other financial statement users to assess the reliability of management's reserve estimates over time. These claim development tables are more effective than theoretically calculated risk margins would be in portraying the relative riskiness of insurers and lines of business in a transparent manner.

For the items specifically noted in Paragraph 106:

- a. The UPR should not be reduced at inception by the incremental acquisition costs. The premium should be earned, and the UPR released, over the coverage period.
- b. Interest should not be accreted on the carrying amount of the pre-claim liability.
- c. The pre-claim liability should be recognized over the coverage period (generally one year or less). Losses should be recognized immediately for contracts that are determined to be onerous; but this would rarely occur during the relatively short coverage period. It would be unusual for substantial credible changes to occur over this short period that would cause contracts to become onerous during the coverage period.



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- d. Presentation in financial statements should be consistent with the presentation framework currently in place in the U.S., as described more fully in the first two paragraphs of our response to this question. Premiums should be presented on an earned basis, and there should be separate reporting of unearned premium reserves and claim reserves as well as uncollected premium balances.

20) Do both the building-block approach and the modified approach (with the latter approach applied only to certain short-duration contracts) produce relevant and decision-useful information? Why or why not?

Response with Respect to Non-Life Insurance

No. Neither the building block approach nor the modified approach (as described in the IASB's ED) would produce relevant and decision-useful information for non-life insurance contracts, for the reasons described more fully in our response to Question 22 below. The modified approach described in the DP includes more flexibility than the modified approach described in the IASB's ED; but we cannot comment on the relevance and decision-usefulness of that proposal because there are too many questions and unresolved issues about what that approach would require.

Response with Respect to Life Insurance

For life insurance, the building block approach as described in the DP, with the modifications described in our other responses in this letter, would provide relevant and decision-useful information. The principal modifications that would be needed to make the results relevant and decision-useful are changes and clarification in the discount rate building block. We think that additional modifications would be needed to make the results of the building block approach described in the IASB's ED relevant and decision-useful, especially changes in the margins building block (risk adjustment and residual margin).

Furthermore, we believe that the relevance and decision-usefulness of results shown in the summary margin presentation proposed in the IASB's ED would be limited. We do note the statement in Paragraph 125 of the DP that the majority of FASB members agree with the IASB's proposal to use a margin presentation regarding insurance contracts measured under the building block approach. We are providing detailed explanations of these views in our comment letter to the IASB on its ED.

21) How should the scope of insurance products for each approach be defined (for example, duration of coverage period, duration of claims payment period, or type of insurance)?

Response with Respect to Non-Life Insurance

The scope of insurance products for each approach should be as defined in current U.S. GAAP (in Paragraphs 7 and 8 of SFAS 60, Codification Section 944).



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22) Are there specific types of insurance contracts for which the approaches would not provide decision-useful information?

Response with Respect to Non-Life Insurance

Neither the building-block approach nor the modified approach (as described in the IASB's ED) would provide decision-useful information for most non-life insurance contracts. The modified approach described in the DP includes more flexibility than the modified approach described in the IASB's ED; but we cannot comment on the relevance and decision-usefulness of that proposal because there are too many questions and unresolved issues about what that approach would require.

Neither the building-block approach nor the (IASB's) modified approach results in a measurement consistent with the non-life insurance business model. The modified approach proposed by the IASB is overly complicated with no reporting benefits or insights as compared to the UPR approach. The modified approach should produce results that do not differ materially from the UPR approach which does not include discounting or interest accretion. We recommend removing the complexity of discounting and interest accretion from the modified approach, neither of which contributes materially to the results for short duration contracts, the only contracts that would be subject to the modified approach in the IASB's proposals.

We provided detailed responses to several questions elsewhere in this letter concerning the appropriateness of discounting and explicit risk margins for short duration non-life insurance contracts. We do not think that the building blocks model would increase the financial statement relevance of claim liabilities for short duration contracts as compared to the current U.S. GAAP model which has been time-tested and which the investor analysts who follow the short duration non-life insurance businesses understand and prefer to retain. The current model is widely understood and is the primary model used in most of the world. The current model is constantly trued up and updated with the latest trends experienced for the actual claims being paid.

In contrast, the use of a financial model including explicit risk adjustments and discounting can never be back tested and can never be reconciled to actual claims paid. A risk adjustment intended to represent the maximum amount that an insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected is a purely hypothetical concept, and not representative or reflective of the information needed to assess insurance operations and business results for non-life insurance contracts.



23) What are the implications of the recent U.S. healthcare reform to the application of the proposed contract boundary principle, including whether health insurance contracts written under the new reforms would meet the conditions in the proposed guidance to be accounted for under the modified approach?

Response with Respect to Non-Life and Life Insurance

Some of the implications of recent U.S. healthcare reform to the application of the proposed contract boundary principle will not be clear until more is known about how the reforms will be implemented and how they will evolve in the future. The boundary principle, as proposed in Paragraph 46, is based in part on whether and when the insurer has the right or the practical ability to reassess the risk of the policyholder and, as a result, can set a price that fully reflects that risk. With some current health insurance contracts and with existing law and regulation, the insurer may be able to fully reflect the price of risk on a portfolio basis, but can not do so on an individual contract basis. In some cases, the insurer's right to fully reflect the price of risk may not be immediately available, but is reasonably expected over time. The guidance for the contract boundary principle should clarify whether such circumstances constitute a practical ability to reassess risk and set a price that fully reflects the risk.

24) What other changes should be considered to both improve and simplify U.S. GAAP for short- and long-duration insurance contracts?

Response with Respect to Non-Life Insurance

Since the U.S. GAAP model is widely used globally for non-life insurance contracts, the model's merits have already been substantiated. Investor analysts are not clamoring for widespread or significant changes to the U.S. GAAP accounting model for short-duration non-life contracts; although targeted changes to address specific concerns should continue to be considered.

Response with Respect to Life Insurance

We believe that the DP proposals are an appropriate starting point for changes to improve and simplify U.S. GAAP with respect to life insurance contracts. We think that several changes are needed to this starting point as we describe in this letter, especially in the discount rate building block.



25) What are the incremental costs of adopting the alternatives described in this Discussion Paper? Please separately describe one-time costs and ongoing costs.

Response with Respect to Non-Life and Life Insurance

Incremental one-time costs of adopting the alternatives described in the DP include:

- new systems;
- new ways of capturing and funneling data;
- developing a new framework for presentation and disclosure; and
- developing new models that are consistent with a modified premium approach, changes in claim liability measurement, increased use of stochastic approaches, and incremental acquisition costs (at the individual contract level).

There will also be significant one-time costs of educating management and investor analysts, and training staff. We expect higher ongoing costs of measuring and reporting according to the new standard, because of the added complexity of the proposed models. We expect that results according the new standard will be more volatile, and more analysis will be required to understand and explain these results. Management of many companies will most likely retain significant parts of the existing reporting framework for non-life insurance contracts, because it contains information that is more useful in understanding and making management decisions about the business.



Reinsurance

26) The scope of the proposed guidance includes reinsurance contracts that an insurer issues or acquires. However, insurance contracts held directly by other policyholders would be excluded from the scope of the proposed guidance. Do you agree with this exclusion? Why or why not?

Response with Respect to Non-Life and Life Insurance

No. Insurance contracts held directly by other policyholders should not be excluded from the scope of the proposed guidance. Similar contracts should be measured consistently, regardless of who holds the contracts. The scope exclusion related to policyholder accounting could result in inconsistent measurement of similar contracts depending on who holds the contract.

27) Should there be symmetry between the recognition and measurement of reinsurance contracts and the underlying contract ceded?

Response with Respect to Non-Life and Life Insurance

Yes, there should be symmetry between the recognition and measurement of reinsurance contracts and the underlying contracts ceded. Reinsurance measurement should follow the measurement model used for the underlying direct insurance contract. Under the proposed model, this would not always be the case (e.g., if the direct insurance contracts are measured according to the modified approach, but the contract(s) under which they are reinsured is (are) measured using the building blocks approach).

A way to keep the measurement of direct business consistent with the measurement of the reinsurance would be to calculate the direct insurer's liability on both a gross (excluding the reinsurance) and net (reducing the insurer's risk consistent with the terms of the reinsurance), and using the difference between the gross and net amount as the reinsurance asset.

In the next round of deliberations on a financial reporting standard for insurance contracts, the Boards should have a more complete discussion of the treatment of reinsurance ceded and assumed.



Presentation and disclosure

28) The margin presentation approach highlights the changes in the insurance liability, rather than the current approach in U.S. GAAP, which presents, among other items, premium revenues, benefits paid, operating costs, and changes in loss estimates. Would this change improve your understanding of the performance of an entity that provides insurance (for some types of insurance or for all)? Please explain.

Response with Respect to Non-Life Insurance

No. The change to a margin presentation approach would not improve our understanding, or the understanding of users, of the performance of non-life insurance entities. According to Paragraph 125 of the DP, a majority of FASB members agree with the IASB's proposed margin presentation. Based on the presentation proposals in the IASB's ED, the margin presentation would be used for claim liabilities of non-life insurance contracts, but would not be used for pre-claim liabilities of most of these contracts (those subject to the PAA). Applying different measurement and presentation bases to different liabilities of the same contracts would be confusing and not decision useful.

We are particularly concerned that the margin presentation would not tie to the key performance measures and information in claim development tables. The face of the financial statements should include important information about premiums and claims. This information is critical for users to understand the overall volume, growth, loss ratios, and claims development - key measures of performance for non-life insurance.

While no specific question is asked, the proposed presentation requirements for the Statement of Financial Position call for reporting either a net asset or net liability for each insurance portfolio. This will not provide useful information on the face of the financial statement particularly for non-life insurance contracts. Users would benefit from separate reporting of unearned premium reserves and claim reserves as well as uncollected premium balances. There generally would not be a right of offset between assets receivable from one policyholder with a claim obligation owed to or on behalf of another policyholder. Loss reserves and unearned premium reserves for non-life insurance contracts convey important information to users. A net presentation of such items would result in a significant reduction of decision useful information on the face of the balance sheet.

Response with Respect to Life Insurance

While the margin presentation approach may provide relevant disclosure information regarding life insurance companies, it does not result in performance statements that would be relevant and useful in the decision making process for financial statement users. Presentation of revenues and expenses as measures of performance would be more comparable to the measures presented for other financial services and non-financial services companies.



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Premiums and benefits are key performance metrics used by investors, analysts and other users for determining the health and future prospects of life insurance entities. These measures have been widely and historically accepted for determining top-line revenue, loss ratios and other financial measures relevant to insurance entities. Premiums and benefits represent financial statement items that are comparable among companies, well understood, and verifiable.

In contrast, the release of a margin is based on allocations, estimates, and significant management judgment, all of which can vary greatly among companies. If financial statement presentation is based on the margin approach, users will rely less on the statements and will have to rely more on disclosures and non-financial statement measures to assess performance.

We would give more consideration to use of the margin approach, either for presentation or for supplemental disclosure, based on a more complete description of the Boards' proposals for such an approach.

29) Should insurance contracts measured under the building-block approach be presented using a margin presentation approach or a premium presentation approach that would require a true-up amount as described in Paragraph 119 (for example, the written allocation presentation approach or the allocated premium presentation approach)?

Response with Respect to Non-Life Insurance

As described in our response to Question 28 above, we do not favor a margin presentation approach or a building block measurement approach for most non-life insurance contracts. The true-up amount described in Paragraph 119 (reconciling the difference between: a) Premium revenue and claims and benefits expenses presented in the statement of comprehensive income; and b) The amount of composite margin recognized in current period earnings) is not meaningful for non-life insurance contracts. As stated in several of our answers to questions in the DP, we do not favor an explicit margin in the measurement of non-life insurance contracts.

Response with Respect to Life Insurance

As we stated in our response to Question 28 above, we do not favor the margin approach for presentation of financial results for life insurance contracts. We do favor a presentation that includes premium revenue and claim and benefit expenses. Additional information (as described in Paragraph 119) on the amount of the composite margin recognized in current period earnings could be useful in disclosure; or perhaps in the financial statement, depending on how that presentation is structured.



30) Should short- and long-duration (or non-life and life) contracts be presented in a similar manner if such contracts are measured under different approaches?

Response with Respect to Non-Life and Life Insurance

We favor a two model approach for measuring insurance liabilities (using a different approach for measuring most non-life insurance contracts than the approach used for other insurance contracts). However, we also favor a premium based presentation for all insurance contracts, so the presentation would be similar for all insurance contracts, even though the measurement models may be different. Our objections to the proposed margin presentation approach are covered in our responses to Question 28 above.

31) Do you agree with the proposed disclosures in the IASB's Exposure Draft? Why or why not? If not, what would you recommend and why?

Response with Respect to Non-Life Insurance

No. We do not agree with the proposed disclosures in the IASB's ED. The proposals include information that is not necessary to support the proposed disclosure principle in the IASB's ED (to help users of financial statements understand the amount, timing, and uncertainty of future cash flows arising from insurance contracts), and would require preparers to disclose an excessive volume of information that would be confusing to many users. The disclosure requirements regarding non-life insurance should focus on information about the entity's underwriting, risk management, and claim estimation practices and the results thereof.

Many of the proposed disclosure requirements assume a degree of meaning and precision in calculated margin numbers that would not exist. Some of the required disclosures, most notably the sensitivity analysis, are too detailed and conceptual. Any requirements for such disclosure should be less specific, providing guidance to insurers that will allow flexibility to disclose information in a way consistent with how the business is managed and how sensitivities and risks are assessed.

The proposed disclosure requirements for reconciliation of all components of the insurance liability, including the risk adjustment and residual margin, would not be helpful to investors and other financial statement users in understanding the amount, timing, and uncertainty of actual cash flows for non-life insurance contracts. In general, we find the proposed disclosures overly burdensome, without sufficient regard to materiality of the information or the time and cost to prepare it, and with significant danger of causing confusion and misunderstanding of the information presented.



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Response with Respect to Life Insurance

No. We do not agree with the proposed disclosures in the IASB's ED. The quantity and detail of the proposed required disclosures in Paragraphs 79-97 of the ED are excessive, and certain of the proposed required disclosures would not provide meaningful information to users. They would serve to overwhelm the reader with information that is not useful for decision making. A cost-benefit analysis should be performed for each of the proposed disclosure sections.

We agree that the components within the contract balance reconciliations of Paragraphs 86-87 of the ED provide meaningful information at a total company level. However, disaggregating these components at a portfolio level would generally provide little additional benefit at an unreasonable cost to preparers. Large insurers could have hundreds of portfolios. The disclosure requirements should allow insurers flexibility in the level of aggregation of the information presented, considering the relevance and reliability of the information, the costs of preparation relative to those benefits, and the ability of preparers to provide the information within the limited time available.

We also agree with general requirements to disclose information about sensitivities to changes in variables and uncertainty around the measurement of these variables. However, we question the added value by providing the sensitivity information at the granular level of detail that is proposed in the IASB's ED. We are particularly concerned that the quantitative requirements for the measurement uncertainty analysis in Paragraph 90(d) and the sensitivity analysis in Paragraph 92(e) (both of these references are to paragraphs in the IASB's ED) may be imposed at a level of detail that would be excessive. As noted above, large insurance companies may have hundreds of different portfolios of insurance contracts, and disclosures of uncertainty and sensitivity analyses at the portfolio level is not likely to provide meaningful, decision-useful information for most users. In order to reasonably estimate the total financial statement impact of using different inputs in the liability measurement model, it is necessary to run models under different scenarios and update all the derivatives of these inputs to arrive at a meaningful result. It would be extremely time consuming and expensive to do so at a very granular level, without producing corresponding benefits to users or to management.



Additional question for respondents

- 32) After considering your views on the specific issues contained in this Discussion Paper and the IASB's Exposure Draft, what do you think would represent the most appropriate improvement in U.S. GAAP?**
- a) Pursue an approach based on the IASB's Exposure Draft?**
 - b) Pursue an approach based on the IASB's Exposure Draft with some changes? Please explain those changes.**
 - c) Pursue an approach based on the Board's preliminary views in this Discussion Paper?**
 - d) Pursue an approach based on the Board's preliminary views in this Discussion Paper with some changes? Please explain those changes.**
 - e) Make targeted changes to address specific concerns about current U.S. GAAP (for example, items included in paragraph 7)? Please describe those changes.**

Response with Respect to Non-Life and Life Insurance

With the overriding need for separate measurement models for life and non-life insurance contracts, and with only the five choices that are listed, we think that appropriate improvements could best be achieved through choice d) for life insurance contracts (to pursue an approach based on the Board's preliminary views in this DP with some changes); and choice e) for non-life insurance contracts (make targeted changes to address specific concerns about current U.S. GAAP). The current U. S. GAAP standard has been proven to be effective for non-life insurance contracts, not only in the U.S., but globally as well. The changes we propose for life insurance to the positions in the DP are covered in our responses to the other questions in this letter. Some of these changes would be very significant modifications to the preliminary views in the DP, especially changes in the discount rate building block.

We do not think that choices a), b), or c) would lead to appropriate improvements because these choices are either based on the IASB ED or on the FASB's preliminary views in the DP without changes. For reasons described in our responses to the other questions in this letter and in our comment letter to the IASB on its ED, we think that there are fundamental flaws in the IASB ED proposals, and that changes (some of which are substantial) are needed in the preliminary views in the FASB DP for life insurance contracts. While it would be possible to make some of the changes we propose for life insurance contracts through choice e), some of the changes would be complex and difficult to make on this basis.

As the FASB continues to deliberate with the IASB on a converged global standard, we encourage you to advocate for the changes described in this letter for life insurance contracts, and for the current principles embedded in U. S. GAAP for non-life insurance contracts as these principles have been proven to be effective and provide useful information to regulators, investors and other financial statement users, not only in the U.S., but globally as well.



Additional comment on revenue recognition

We would also like to comment on Revenue Recognition with respect to insurance contracts. We commented on the IASB and FASB Exposure Draft, Revenue from Contracts with Customers (Topic 605)(File Reference No. 1820-100)(Revenue Recognition ED), in a letter dated October 22, 2010. While insurance contracts are scoped out of the Revenue Recognition ED, we noted in our letter that application of the Revenue Recognition ED to short-duration non-life insurance contracts would be consistent in many ways with the PAA proposed in IASB's ED on insurance contracts; but that the Revenue Recognition ED is not well suited for many long duration contracts (including life insurance contracts) and certain reinsurance contracts. We agree with the observations on revenue recognition in the Basis for Conclusions section of the IASB's insurance contracts ED (Paragraphs BC20 – BC32), both with respect to non-life insurance and life insurance contracts. This adds further support for an approach that aligns measurement guidance with the business model of insurers, which is fundamentally different for life and non-life insurers as described above.

We agree that it is appropriate to scope insurance contracts out of the Revenue Recognition ED. We further suggest applying principles from that ED to short-duration non-life insurance contracts within the ED on insurance contracts, and applying different principles to revenue recognition for life and other long-duration insurance contracts, as described below. As we state throughout this letter, the measurement and financial reporting for life and non-life insurance contracts should be consistent with the unique attributes of their individual business models.

- 1) In general, the only performance obligation of insurance contracts is to provide protection against insured losses. For long-duration insurance contracts (such as life insurance), there is no value in considering the coverage provided for each reporting period to be a separate performance obligation. The general principle should be that the insurer will recognize revenue as it is released from the insurance risk over the entire duration of the coverage.
- 2) This principle (of recognizing revenue as the insurer is released from the insurance risk over the entire duration of the coverage) is particularly beneficial for contracts in which the risk may fluctuate up and down unpredictably (e.g., equity linked life insurance), or where it is difficult to allocate the risk to sub-periods of time over the duration of coverage (e.g., stop loss reinsurance contracts).
- 3) There is also no value in defining protection against a decline in insurability as a separate performance obligation for purposes of revenue recognition. The protection against a decline in insurability is an issue for the boundary of an insurance contract, and is adequately addressed in the DP by the condition in Paragraph 46b. (that relates the contract boundary to when the insurer "has the right or the practical ability to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects the risk").



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- 4) Similarly, there is no value in separately defining investment management or contract administration as separate performance obligations of an insurance contract. Paragraph 9 of the IASB's insurance contracts ED provides that if the account balance of an insurance contract is unbundled, "an insurer shall regard all charges and fees assessed against the account balance, as well as cross-subsidy effects included in the crediting rate, as belonging to either the insurance component or another component, but are not part of the investment component." We state our concerns about the unbundling proposals in the DP in our response to Question 6 above.

- 5) We support the approach described in the DP to include certain acquisition costs in the cash flows included in the initial measurement of insurance contracts. This approach more appropriately addresses acquisition costs of long-duration insurance contracts than the approach taken in the Revenue Recognition ED (which would expense all such costs when incurred). While we support the acquisition cost approach in the DP, the proposals for what costs are included in this measurement are too narrow. Our concerns are covered in our response above to Question 14.

Sincerely,

A handwritten signature in black ink, appearing to read "Jerry de St. Paer". The signature is written in a cursive, flowing style.

Jerry de St. Paer
Executive Chair, GNAIE

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