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**Regarding: A Discussion of Preliminary Views on Insurance Contracts
Reference : 1870-100**

Reviewed By: Dr. Joseph S. Maresca CPA, CISA Due on 12-15-2010

Colleagues,

Thank you in advance for the opportunity to critique Preliminary Views on Insurance Contracts. Details follow.

Background

Contracts which transfer risk should be accounted for similarly. A uniform definition of an insurance contract should be developed, although the Uniform Commercial Code may be a better place to address definitional issues as to the rights, duties, obligations and recourse of the parties to the transaction. The framers identify with the term compensation rather than indemnification to identify the contract benefit. Generally, acquisition costs should be expensed as incurred. Assumptions should be re-evaluated each contract period, although the actuarial sciences may be the better place to perform this type of analysis.

The discount rates used to measure the contract liability should be based on current rates which reflect the characteristics of the liability rather than the invested assets .
Measurement of all contract liabilities should be discounted at current rates to reflect the time value of money.

Critique

A number of questions have been formulated for the respondents; namely,
(1) Are the proposed definitions of the insurance contract and risk understandable and operational?

Yes, the definitions are understandable, although the actuarial sciences may be a better place to address risk assessments due to the historical experience of actuaries, actuarial tables and standardized actuarial algorithms. Due to the existence of cloud computing, a multiplicity of users can share complex algorithm processing at a reasonable cost utilizing standardized data management protocols.

(2) If the scope of guidance is based on the definition of an insurance contract would financial reporting be improved?

Yes, financial reporting should be aligned with the legal definition, the rights, duties , obligations and recourse of the major parties to the transaction.

(4) Should benefits an employer gives to employees that meet the definition of an insurance contract be within the scope?

Medical benefits from employers to employees do not meet the definition of an insurance contract for purposes of providing the guidance. The employee isn't a customer.

Theoretically, benefits of an employer to an employee should be excluded from the guidance. Some large companies self-insure using a 3rd party provider for claims administration for cost containment.

This may be an alternative to contracting for medical coverage directly. There is a proviso. The treatment of the patient shouldn't be adversely impacted by self-insurance. In addition, the paperwork of the medical provider should be kept to a minimum to provide patients with medical care rather than a mound of paperwork.

(6) Should non-insurance components of contracts be unbundled? Yes. The unbundling will remove non-insurance product paperwork and enhance reporting relevance.

(7) Should probability weighted estimates of net cash flows be employed to measure insurance contracts? Does this faithfully represent the economic dimensions of an insurance contract. The response is **undecided** because this question straddles the actuarial sciences. Probabilistic algorithms may be utilized uniformly in cloud computing environments where the programming and computing costs can be shared amongst a community of users.

(8) Should the estimate of net cash flows include a risk adjustment margin? Yes. Again, this area straddles the actuarial sciences.

(9) Is the risk adjustment margin understandable? Yes, the idea is understandable but the compliance burden may be increased as a consequence of practical application.

(10) Is the risk adjustment margin comparable for entities exposed to similar risks. Yes.

(11) Should cash flows be included in the measurement of the insurance contract?

Yes. The relevant cash flows apply to the contract taken as a whole over the short and long term.

(12, 13) Should the carrying amount be discounted if the effect is material?

Yes. The discounted amount would provide readers of the financial statements with a more realistic measurement statistic. A related issue involves the inclusion of acquisition costs as cash flow components of the contract.

(15, 17) Is the composite margin approach preferred for implementation in the insurance contract?

Yes. Application of the composite margin is less complex. The insurer may apply the ratio to the composite margin determined at the initial recognition of the insurance contract.

The resultant amount less the composite margin recognized in earnings in previous periods will be recognized in current period earnings.

**# 83 The Composite Margin Recognized in Earnings =
Premium allocated to date + claims and benefits paid**

Total expected premiums + Total Expected Claims and Benefits

Also, interest may be accreted under the composite margin approach.

(20) The building block and modified approaches produce useful information.

The Board concluded correctly that non-insurance components or elements may be unbundled to afford better transparency, comparability and uniformity. #39

The boundary of the insurance contract distinguishes net cash flows of existing insurance contracts from future insurance contracts and insurable interests.

(21) The scope of the insurance product should be related to the coverage period to provide users of financial statements with a definition commonly understood by the general public.

(23) What are the implications for the USA/Health Care Reform vis-a-vis the contract boundary?

Generally, the benefits provided by an employer to an employee may be excluded from the guidance. The current USA/Health Care Reform package is aimed at covering the broadest general public constituency of potential patients. The health care constituency includes workers, their families and people outside the traditional insurance pool of participants. In addition, there are government-based health care delivery systems which are a part of medical schools, the National Institutes of Health, neighborhood health care clinics and the Hill Burton Act. The Act provides a sliding scale health care payment schedule to patients in exchange for forgiveness of the medical facility mortgage either full or part.