

December 15, 2010

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Reference: Insurance Contracts Discussion Paper (File Reference No. 1870-100)

Dear Technical Director:

Factory Mutual Insurance Company ("FM Global") welcomes the opportunity to comment on the insurance contracts discussion paper issued by the FASB in September 2010.

FM Global is a leading commercial and industrial property insurer of the world's largest businesses, providing more than one-third of FORTUNE 1000-size companies with engineering-based risk management and property insurance solutions. Ranked 545 on the FORTUNE 1000 list of America's largest companies, FM Global employs more than 5,100 employees worldwide. FM Global is operating in more than 130 countries worldwide. As of December 31st, 2009, total assets and total stockholders' equity of FM Global were US \$12.9 billion and US \$6.3 billion, respectively.

This discussion paper represents a significant milestone in the FASB's efforts to adopt a high quality, principles-based global insurance accounting standard. FM Global supports FASB's initiative and effort to harmonize international accounting practices.

Under the requirements of discussion paper, most of FM Global's insurance contracts would be covered under the modified measurement approach and therefore most of our answers within the comment letter are focused primarily on this approach. Please note that FM Global <u>strongly supports the utilization of modified measurement approach</u> for short duration contracts, and have put in significant effort in this comment letter to assist FASB in filling any informational gaps/inconsistencies with this approach. Please see the attached appendix for our specific responses to the discussion paper questions for respondents.

We appreciate the Board's consideration of our comments and would be happy to discuss them in more detail if needed. Please feel free to call me at 1 (401) 415 1669 at your convenience.

Sincerely,

Theresa Molloy Controller, FM Global theresa.molloy@fmglobal.com 1 (401) 415 1669

cc. Jeffrey Burchill, Senior VP and CFO, FM Global

Appendix:

Question 1 – Definition and Scope

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

The proposed definition of an *insurance contract* is generally understandable and operational. However, the proposed definition of *insurance risk* within the *insurance contract* definition is too broad and not clearly defined.

Currently, insurance risk is defined as "risk, other than **financial risk**, transferred from the holder of a contract to the issuer". We recommend that FASB adopt the existing Topic 944 definition of insurance risk where it is defined as "the risk arising from uncertainties about both <u>underwriting risk</u> and <u>timing risk</u>. Actual or imputed investment returns are not an element of insurance risk. Insurance risk is fortuitous; the possibility of adverse events occurring is outside the control of the insured".

Question 2 – Definition and Scope

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?

No, we do not believe that changing the basis of scope of the proposed guidance on insurance contracts from the "definition of insurance contract" to the "type of entity issuing the contract" would improve financial reporting.

Our concerns are that companies would have to invest a significant amount of time and resource to familiarize themselves with complicated insurance accounting requirements in which they don't do regular business and in some cases will be immaterial.

Question 3 – Definition and Scope

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

We generally agree with scope exclusions since they relate to areas where detailed guidance is available in other accounting standard codification ("ASC") topics. The only exception relates to direct insurance contracts that an entity holds where there is no specific guidance available. Please provide more guidance on direct insurance contracts that an entity holds.

Question 4 – Definition and Scope

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?

No, benefits that an employer provides to its employees that otherwise meet the definition of an insurance contract should not be within the scope of the proposed guidance. Such benefits should be accounted in accordance with the relevant employee benefits standards or any other applicable standard.

Question 5 – Definition and Scope

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?

No comments.

Question 6 – Definition and Scope

Do you support the approach for determining when noninsurance components of contracts should be unbundled? Why or why not?

No comments.

Question 7 – Recognition and Measurement

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?

No, we do not agree with the use of probability-weighted estimate of net cash flows to measure insurance contracts. The probability weighting of cash flows implies a greater level of precision in the measurement than actually exists. Currently, in the Property & Casualty insurance industry, best estimates are used to determine case reserves. The requirement for probability weighting would require companies to define estimates of probabilities, and then, calculate a weighted average estimate. We believe the weighted average will be reasonably close to the best estimate of a loss.

For example, for a specific property claim, let us assume that an insurance company has a case reserve of \$10 million and a development amount of \$1 based on their actuarial calculated best estimates. With this new requirement of probability weighting, the insurance company has to come up with all possible scenarios that may happen, and assign probabilities to it. The only way the company would know whether the probabilities assigned by them are correct is if the net result of the probability weighting calculation is similar to the best estimate provided by the experienced adjuster. In this example, the company may come up with the following probable scenarios - 90% probability of \$10 million loss, 9% probability of \$2 million loss, and 1% probability of \$40 million loss. Note all the assigned probabilities would generally have no real basis to support them. The intention behind all these figures would be to come up with a probability weighted figure that is close to the adjuster's estimate.

FASB (as well as IASB) should reconsider the reasons for requiring probability weighted cash flows. Per IASB, the reason is that probability weighting considers the inherent uncertainty in the amount and timing of cash flows.

This argument is not persuasive due to the fact that based on the current guidance per IASB ED; there is an additional requirement to calculate risk adjustment to account for the risk that ultimate cash payouts may be higher than the expected cash outflows. Hence, the uncertainly is covered under the risk adjustment. We believe that IASB (and FASB) should not create more work for the insurance companies by requiring them to incorporate uncertainty within the cash flow estimates as well.

Ultimately, our request to the Boards is to allow companies to utilize their best estimates in the determination of cash outflows (for both incurred claims as well as future claims). From a cost-benefit analysis perspective, it does not make sense to define subjective probabilities on future cash flows that will approximate the best estimate that companies have been utilizing for decades.

The current insurance accounting standards in the US are pretty robust with sufficient adequate data available to define the reasonability of the estimates determined by the insurance companies, and hence, this additional requirement to include probability weighted estimates would add more subjectivity, without any significant additional benefit.

Question 8 – Recognition and Measurement

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

Yes, we do think that entity's estimate of net cash flows should include a risk adjustment margin. This is because risk adjustment calculation requires an insurance company to reflect on the risk that the expected cash outflows calculated by the company could be different from the actual cash outflows in the future. Without this explicit calculation, it is possible that companies may not pay adequate attention to this potential risk. Also, it is important for the users of the financial statements to know that companies have considered this risk, and have adjusted the cash outflows accordingly.

Further, as stated in the response to question 7, if the cash outflows are allowed to be calculated on the basis of best estimates by the Boards, the risk adjustment becomes an even more important calculation in order to include the uncertainty/risk that future actual cash outflows may be higher than the expected future cash outflows.

If FASB decides to include the risk adjustment margin within the estimate of net cash flows, we recommend providing additional guidance and examples on the risk adjustment calculation. In addition, in order to enable comparability between financial statements of insurance companies, we believe that FASB should prescribe ranges/parameters (similar to standard actuarial practice under Canadian GAAP) for the risk adjustment calculation (please see question 10 for further details). **Question 9 – Recognition and Measurement**

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?

Yes, the objective of risk adjustment margin is understandable. The main reason to require risk adjustment is to consider and account for the potential risk that future actual cash outflows may exceed the expected values calculated.

However, we do not agree with the definition of the risk adjustment as stated within both the IASB ED and FASB DP. Per the current definition, the risk adjustment depicts the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected.

The reason for our disagreement is that this definition of risk adjustment brings the exit value concept (under which risk adjustment would be the maximum amount insurer would rationally pay to a third party to be relieved of the related risk) back into picture, which is a fundamentally different perspective than the fulfillment perspective (under which risk adjustment would be the maximum additional amount that insurer would have to pay in order to be relieved of the liability to the related policyholders) utilized

within this exposure draft. Hence, we propose that the risk adjustment should be defined as "the amount that would need to be added to the expected fulfillment cash outflows to account for the risk that ultimate fulfillment cash outflows may exceed those expected".

We do not believe that IASB as the accounting standard setting body should dictate the methodology for calculating the risk adjustment which falls within the domain of the actuarial practice. Hence, we believe that IASB should outline the overall objectives of the risk adjustment amount, and allow the actuarial bodies to determine the best practice to fulfill the related objectives set by IASB.

In addition, we believe the IASB should prescribe ranges/parameters (similar to standard actuarial practice under Canadian GAAP) for the risk adjustment calculation. This will decrease the variability in calculation of risk adjustment between different companies.

Question 10 – Recognition and Measurement

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

No, the risk adjustment as proposed within the IASB ED would be difficult to compare between entities that are exposed to similar risks. This is because, the proposed techniques to calculate the risk adjustment allow for too much flexibility, hence, making comparability between entities difficult.

In order to make risk adjustment margin comparable for entities, IASB we recommend prescribing ranges/parameters (similar to standard actuarial practice under Canadian GAAP) that apply to the risk adjustment calculation. This will decrease the variability in calculation of risk adjustment between different companies.

Question 11 – Recognition and Measurement

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?

Yes, although we have requested the Boards to allow for best estimates of the cash flows to be utilized in the insurance liability calculations as opposed to probability weighted cash flows (please see response to question 7), we generally agree with the description of cash flows that should be included in the measurement of an insurance contract. We believe that proposed guidance is operational.

Question 12 - Recognition and Measurement

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?

No, we do not believe that discounting provides relevant useful information to the users of financial statements with respect to property and casualty insurance.

With respect to short tail property insurance, impact of discounting would be immaterial. Hence, requiring discounting for all short-duration contracts would add additional cost of computing the discounted figures without substantial benefit for the users of the financial statements.

For long tail property insurance such as worker's compensation and general liability (asbestos and environmental exposures), discounting has some merit because these lines of business have longer payout

periods. However, for such contracts the payout periods would be based on the assumptions utilized by the individual companies, which may be different for different companies based on their level of conservatism. Therefore, the payout periods utilized within the discounting calculation would reduce the comparability of the financial statements of different companies.

If discounting is required, we agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability. However, we feel that adequate guidance has not been provided on the measurement of illiquidity adjustment. If IASB is unable to provide adequate guidance on liquidity adjustment, then, in order to ensure that insurance company financial statements are comparable, we request IASB to either prescribe liquidity adjustment (as done within Solvency II), or leave the discount rate at the risk-free rate. Following one of these two proposed alternate methods, the IASB will be able to better achieve its objective to ensure comparability of financial statements of different insurance companies.

Question 13 – Recognition and Measurement

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?

Yes, within general measurement (building blocks) approach, the acquisition costs should be included as one of the cash flows relating to the contract. This is because, these costs are essentially cash outflows related to the contract, and these cash outflows impact the profitability of the contract (i.e. margin calculation).

However, in the modified measurement approach used for short-duration contracts, it is more useful for the readers to know the explicit acquisition costs, and explicit unearned premium figures. Hence, we recommend that Boards allow unearned premiums to be the basis for pre-claims liability, and allow deferred acquisition costs to be set up as a separate asset on the balance sheet. Further, from income statement perspective, earned premiums and amortization of incremental acquisition costs should be presented separately

It is interesting that IASB ED has agreed with our above recommendation on the income statement side. However, they have gone with the single liability (netting unearned premiums, incremental acquisition costs, and claims liability as one figure) presentation on the balance sheet side. We strongly recommend that the Boards allow (under modified measurement approach) the presentation of three different line items on the balance sheet – pre-claims liability, claims liability, and incremental acquisition costs. This approach is more decision-useful for the readers of the financial statements, then, one net liability figure.

Having stated the above, if the reason for the presentation requirement for balance sheet is to accommodate the companies that may offer both short-duration and long-duration insurance products, the Boards may wish to give exemption or flexibility to the companies in this situation to present the balance sheet under modified measurement approach on the basis of one single liability figure.

Question 14 – Recognition and Measurement

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?

Yes, we 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.

However, we would like to see changes in the definition of incremental acquisition costs. Our recommendation is to include only relevant incremental acquisition costs, which are costs that vary directly with the writing of new or renewed insurance contracts, and can be recouped in case of cancellation of a contract.

Question 15 - Recognition and Measurement

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?

No, for P&C short duration insurance contracts, we do not agree with the use of either the composite margin approach or two-margin approach. Instead, we support modified measurement approach proposed for short-duration contracts under the IASB ED.

These margin approaches (based on building blocks) do not faithfully represent the economics of the insurance contracts. This is because there is significant uncertainty surrounding future cash outflows, as future insurance claims are difficult to predict. The building blocks assume a certain level of specificity and certainty that does not exist in the P&C industry.

For P&C companies, we do not believe that either margin approach is a significant improvement over the current US GAAP which has served the industry well for a long time. Further, the current US accounting standards for P&C companies are quite similar to the ones followed in several large economies around the world. Having stated this, we believe that it is worth the effort to make some changes to the current US standards to ensure that there is one set of accounting standards worldwide for the P&C insurance contracts. Hence, we support FASB's work with IASB to bring US standards in line with the IFRS standards.

However, if we were to choose between the two margin approaches, the preferable approach would be the two-margin approach for the following two reasons –

- i. Considering the nature of our insurance business, most, if not all, of our contracts will fall under the modified measurement approach. Within this approach, per IASB ED, the cash inflows are based on the unearned premium approach, and cash outflows (claims liabilities) are based on the building blocks approach. In determination of the claims liabilities within the modified measurement methodology, there is no concept of residual margin. Instead, only risk adjustment needs to be calculated in order to ensure that claims liability figures are risk adjusted. Hence, it makes sense to keep residual margin, and risk adjustment components separate. Having stated this, we recommend that the Boards should prescribe ranges/parameters (similar to standard actuarial practice under Canadian GAAP) for the risk adjustment calculation. This will decrease the variability in calculation of risk adjustment between different companies.
- ii. The alternate composite margin methodology may not be adequate since it locks the composite margin at inception. That means both risk adjustment component and residual margin components are locked at inception. This is problematic since risk adjustment component of the composite margin may need to change over time with changing circumstances, which is not allowed under the composite margin methodology.

Question 16 - Recognition and Measurement

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?

No, we do not think the composite margin should be recognized in earnings in subsequent period using the ratio described in paragraph 83 of FASB DP. This is because this ratio does not reflect the revenue earnings process accurately. The revenue is earned by an insurance company over the coverage period, which is the period during which the insurance coverage is provided to the policyholder.

Any claims payable at the end of the coverage period is merely a payable resulting from the obligations arising from claims during the coverage period. Hence, we believe that the composite margin should be released over the coverage period (as opposed to coverage period and claims handling period recommended by FASB).

Further, the composite margin release should be (similar to the residual margin release per paragraph 50 of IASB ED) in a systematic way that best reflects the exposure from providing insurance coverage, as follows: (a) on the passage of time, but (b) on the basis of the expected timing of incurred claims and benefits, if that pattern differs significantly from the passage of time.

Question 17 – Recognition and Measurement

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

No, we do not agree that interest should be accreted on the composite margin. This is because the composite margin calculation already takes time value of money in account through discounting expected fulfillment cash flows. Per BC 131(a) of ED, IASB's key reasoning for accreting interest is the following "the accretion of interest reflects the fact that the entity would rationally have charged a different cash amount if the contract had stipulated earlier or later payment by the customer". Please note that this objective to incorporate time value of money is already met through discounting of future cash inflows and outflows. Furthermore, according to the Unfair Claims Settlement Practices Act in US, the insurer cannot withhold payment after the settlement amount is determined, and cannot adjust the settlement amount based on the timing of the payments.

Question 18 – Recognition and Measurement

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?

No, we do not believe that all insurance contracts should be recognized and measured using one approach. We believe that property and casualty short duration contracts should be recognized and measured utilizing modified measurement approach similar to the one proposed within IASB ED (with some changes).

The reasons for our support for the modified measurement approach are following:

- Due to the short term nature of these insurance contracts, modified measurement approach is a good approximation of the building blocks approach. For clarity, short duration of the contracts makes discounting immaterial. Further, the customer consideration (unearned premiums) received for these contracts are the best indicators of the risks inherent within these contracts. This is

because in a market based economy, no corporation would be willing to take risks higher than the related payments from arms length third parties. For the exceptional circumstances (e.g. price reduction for market entry) where there is a willing price reduction below the payments received, the onerous contract liability test becomes applicable, and would require the company to book an additional liability.

- The nature of property & casualty insurance contracts is significantly different from the life contracts. The primary focus for property & casualty insurance contracts is the underwriting activity, rather than the earning of investment income which is the main focus of the life insurance contracts. Further, the life insurance contracts provide coverage for long periods of time, and the expected cash inflows and outflows are more readily determinable. In comparison, the P&C contracts are mainly short-duration, and the timing and occurrence of the claims is uncertain, and hence, not easily determinable.
- The modified measurement approach is similar to the unearned premium approach which is tried and tested with the short duration contracts world-wide. This measurement approach produced good reliable accounting results which stood the test of time.

Ouestion 19 - Recognition and Measurement

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

Recognition -

Short-duration insurance contracts should be recognized at the effective date of the contract. Please note that requiring that the contracts should be accounted for at the bound date is creating unnecessary work for the insurance companies without any significant benefit for the users of the financial statements.

Measurement -

Pre-claims liability = Unearned Premiums (Unearned premiums should be gross amount without deduction for incremental acquisition costs)

Release of pre-claims liability = over the coverage period on a straight-line basis.

Incremental acquisition costs = should be presented as a separate asset on a balance sheet, and released over the coverage period similar to the pre-claims liability. We do not believe that incremental acquisition costs should reduce the pre-claims liability since doing so will reduce the clarity and decision-usefulness of the balance sheet figures.

Interest accretion = no interest should be accreted on the pre-claims liability. This is because the time value of money concept has already been included within the pre-claims liability calculation which includes premiums and expected present value of future premiums.

Onerous contract liability test = this test should be applied in a similar fashion to a premium deficiency test. We believe that the onerous contract test at the initial recognition, or subsequently, should only be performed if there are indicators that suggest significant negative changes in the condition of the insured since the initial underwriting of the related contract. Further, the calculation utilized for onerous contract liability should not be based on the building blocks approach (as doing so would effectively negate the benefit of using the modified approach); rather the calculation should be similar to the existing requirements of premium deficiency calculations within various jurisdictions.

FASB and IASB should refer to the existing requirements for premium deficiency calculations in Canada, US, and UK, and determine a methodology that meets the <u>objective of testing the adequacy of premiums</u>, and still a lot less onerous on the prepares of the financial statements.

Further, we believe that the onerous contract test should be performed at either the "line of business level" or "level at which the key insurance portfolios are being managed by the entity (and should not be required to be categorized by similar date of inception). We believe that calculation at these levels provides sufficient information for the users of the financial statements. If the Boards agree to allow the onerous liability calculation to be done at the line of business level, we request that Boards provide specific criteria and examples on the determination of lines of business.

Presentation -

Balance Sheet

Three separate figures should be presented for pre-claims liability, claims liability, and incremental acquisition costs. Combining these three different figures into one would greatly reduce the decision-usefulness of the balance sheet for the users of the financial statements. This recommendation is different from IASB ED's current proposal where the liability is required to be presented as a single line item. Please note that the presentation of the liability as a single line item works under the general measurement approach since the calculation of the liability is the EPV of net cash outflows for a portfolio of insurance contracts. However, this presentation approach does not work under the modified measurement approach where different liability amounts need to be calculated, a Pre-claims liability and a Claims liability. It would be more useful for the readers of the financial statements to have these two figures separately disclosed, along with incremental acquisition costs.

Income Statement

The following items should be presented as separate line items within the income statement of an insurance company –

- (i) Premium revenue, determined as a gross-release of pre-claims obligation
- (ii) Claims incurred
- (iii) Expenses incurred
- (iv) Amortization of incremental acquisition costs
- (v) Changes in additional liabilities for onerous contracts.

Note that we do not agree with presenting only the underwriting margin within the income statement. We believe that having the items mentioned above as separate line items adds considerably to the usefulness of the income statement.

Question 20 - Recognition and Measurement

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?

Our response to this question is limited to the modified measurement approach as that is what is relevant to us.

No, we do not believe that the proposed modified measurement model will produce additional relevant information over and above that currently under US, Canadian or UK GAAP for short-duration contracts.

There are two main reasons for our position:

• The IASB ED incorporates the concept of discounting on all insurance businesses irrespective of the type of insurance. With respect to short tail property insurance, the impact of discounting would generally be immaterial due to the timely settlement of claims for such contracts. Hence, requiring discounting for all short-duration contracts would add additional cost of computing the discounted figures without substantial benefit for the users of the financial statements.

Discounting does have merit for long-tail insurance such as worker's compensation and general liability (asbestos and environmental exposures) because these lines of business have longer payout periods. However, for such contracts the payout periods would be based on the assumptions utilized by the individual companies, which may be different for different companies based on their level of conservatism. Therefore, the payout periods utilized within the discounting calculation would reduce the comparability of the financial statements of different companies.

• The IASB ED is requiring the calculation of an Onerous Contract Liability based on the expected present value of fulfillment cash flows. This requirement takes away the substantial cost reduction benefits of the simplified modified measurement approach, as companies would need to expend substantial time and resources to prepare this calculation. We believe that current premium deficiency calculations within US and Canadian GAAP, together with the unexpired risk provision under UK GAAP have done an <u>adequate job</u> in ensuring that an additional liability is set up for scenarios where premium deficiencies exist. We recommend the IASB review the existing national GAAP of the US, Canada and the UK to come up with a requirement for calculating a premium deficiency that is closer to the existing regimes.

Question 21 – Recognition and Measurement

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)?

The building blocks approach should be utilized for all insurance products except the short-duration contracts that meet the following criteria:

- (a) The <u>contract boundary</u> of the insurance contract is approximately one year or less from the date of initial recognition of the contract.
- (b) The contract does not contain embedded options or other derivatives that significantly affect the variability of cash flows, after unbundling any embedded derivatives in accordance with paragraph 12.

The alternative to the above recommendation would be follow the FAS 60 definition of short-duration and long-duration contracts as the basis of determining which contracts would be covered under the modified measurement approach:

FAS 60 criteria:

"Insurance contracts, for purposes of this Statement, shall be classified as short-duration or long-duration contracts depending on whether the contracts are expected to remain in force for an extended period. The factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are:

a. *Short-duration contract*. The contract provides insurance protection for a fixed period of short duration and 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.

b. *Long-duration contract*. The contract generally is not subject to unilateral changes in its provisions, such as a noncancelable or guaranteed renewable contract, and requires the performance of various functions and services (including insurance protection) for anextended period.

Examples of short-duration contracts include most property and liability insurance contracts and certain **term life insurance** contracts, such as **credit life insurance**. Examples of long-duration contracts include **whole-life contracts**, guaranteed renewable term life contracts, **endowment contracts**, **annuity contracts**, and title insurance contracts. Accident and health insurance contracts may be short-duration or long-duration depending on whether the contracts are expected to remain in force for an extended period. For example, individual and **group insurance** contracts that are noncancelable or guaranteed renewable (renewable at the option of the insured), or collectively renewable (individual contracts within a group are not cancelable), ordinarily are long-duration contracts."

Question 22 - Recognition and Measurement

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

No comments.

Question 23 – Recognition and Measurement

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?

No comments.

Question 24 - Recognition and Measurement

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

For short-duration contracts, the current US GAAP is pretty robust and has represented the financial position and performance of insurance contracts well. Hence, we do not recommend any fundamental changes to the current US GAAP for such contracts.

However, we believe that the goal of having a unified international insurance accounting standard is worthy, and hence, some compromise may be made by the FASB in order to get to a consensus with IASB.

Question 25 – Recognition and Measurement

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

There are several one-time and ongoing costs resulting from adoption of the alternatives described in the Discussion paper as follows:

One-time costs:

- (a) Consulting costs to perform impact analysis, and detailed implementation assistance.
- (b) System change costs
- (c) Additional new systems costs
- (d) External auditor review costs
- (e) Staff training costs

Ongoing costs:

- (a) Additional external audit costs as calculations would become more complex under the new regime, requiring more audit time.
- (b) Additional actuarial costs related to the calculation of probability weighted cash flows, risk adjustment, and effect of discounting.
- (c) Additional accounting costs as new full time resources may need to be hired to accumulate data needed for the calculation of probability weighted cash flows, risk adjustment, contract bound dates (as opposed to the effective date of the contract), discounting, and onerous liability calculation.

Question 26 – Reinsurance

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?

Yes, we agree with excluding insurance contracts held directly by other policyholders from the scope of the proposed guidance. The reason for this is that liability of a policyholder of insurance contracts is generally limited to the monthly premiums, which are most often expensed. In addition, if a policyholder does not pay the monthly premiums, the main impact on the given policyholder is that insurance policy gets cancelled. For example, if a company gets its property insured through an insurance company, this company is only responsible for payment of the premiums on this property insurance, and would have no other obligation during the term of the policy.

This is different from a reinsurance contract where the obligation of cedent is not limited to payment of premiums. Under reinsurance policies, there is an active sharing of risk between the reinsurer and cedent. This sharing of risk is accounted for through sharing of both the premiums and claims and adjustment expenses between the reinsurer and cedent. This type of sharing of risk does not exist between the insurer and the policyholder. Hence, the reinsurance contract held by an insurance company is a completely different scenario than an insurance contract held by a policyholder.

Overall, we support accounting of reinsurance contracts through insurance contract accounting, and accounting of contracts held by the policyholders through other relevant standards, unless specific guidance is provided on such contracts by the Boards.

Question 27 – Reinsurance

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

Yes, there should be symmetry between the recognition and measurement of reinsurance contracts and the underlying contract ceded.

When an insurance company evaluates their risk on a policy they look to both the gross and net exposures. As such, we feel that that Board should require the same basis of accounting for reinsurance as the underlying insurance contract. For instance, if the insurance contract is accounted for under the modified measurement approach, reinsurance on that contract should follow the same approach. Simply allowing reinsurance contracts to utilize modified approach may not always align the gross policies to related reinsurance.

Example: An insurance company that has a short-duration contract can follow the modified measurement approach to account for that contract. If the related reinsurance utilizes reinsurance contracts with 12 month contract period and 24 month coverage period, then, per IASB ED, the reinsurance may have to be accounted under the general measurement approach. This will create inconsistency as the accounting for reinsurance will not be aligned with the related gross contract, which was the intent of the insurance company to arrive at their net exposure.

We recommend that measurement methodology followed for reinsurance contracts should mirror the measurement methodology followed for the related underlying insurance contracts.

Question 28 - Presentation and Disclosure

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.

Although we understand that the margin presentation agrees with the related building blocks approach for long-duration contracts, we feel that excluding premium revenues, benefits paid, operating costs and changes in loss estimates from the face of the income statement will greatly reduce the usability of the financial statement.

Further, for modified measurement approach, allocated premium presentation is the most suitable.

Question 29 - Presentation and Disclosure

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)?

No comments.

Question 30 – Presentation and Disclosure

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

No, short and long-duration (on nonlife and life) contracts should not be presented in a similar manner when such contracts are measured under different approaches.

The building block measurement methodology is significantly different than the modified measurement methodology for short-duration contracts. The presentation should reflect the underlying calculations. For example, building block measurement methodology for long-duration contracts calculates liability based on net cash outflows. Hence, it makes sense to present the policy liabilities as one single line item on the balance sheet. However, under the modified measurement approach, unearned premiums drive the pre-claims liability, and incurred claims drive the claims liability. Under this approach, it is important to present pre-claims liability, and claims liability separately on the balance sheet.

Utilizing same presentation when underlying calculations are significantly different would have significant negative impact on the transparency and usability of the financial statements.

For further information on this issue, please refer to our response to question 13.

Ouestion 31 – Presentation and Disclosure

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?

Yes, we agree with the overall proposed disclosure principle. This principle puts the onus on the insurer to ensure that adequate disclosures are included to help users of financial statements understand the amount, timing, and uncertainty of future cash flows arising from insurance contracts.

However, we feel that the disclosure requirements in the standard are too extensive without the assurance that information presented would benefit the reader. Examples of such disclosures include the following –

- Reconciliation for Onerous Contract Liability (par. 88(b) of IASB ED) The requirement of reconciliation of Onerous Contract Liability does not add much value for the readers of the financials. The Onerous Contract Liability calculation needs to be updated at the end of each reporting period. Hence, the reason for the change in the value of the Onerous Contract Liability is that the related calculation of expected future net cash flows is changed compared to the previous reporting period.
- Additional disclosure required for contracts not settled within one year (par. 89 of IASB ED) For contracts for which uncertainty about the amount and timing of claims payments is not typically resolved within one year, the ED requires an insurer to disclose the claims and expenses incurred during the period. This additional disclosure does not seem to add significantly to the disclosure of "claims and expenses paid during the year" included within the reconciliation of claims liabilities.

Further, we are concerned about the extent of confidential information that the IASB ED seems to require within the disclosures. For example, with regards to the risks arising from insurance contracts other than insurance risks, par. 93 of IASB ED specifically indicates that the disclosure of summary quantitative information regarding exposure to risk shall be based on information provided internally to key management personnel of the insurer and requires disclosure of information about the risk management

techniques and methodologies applied by the insurer. We believe that these requirements may be disclosing confidential information creating a competitive disadvantage for the insurer.

The disclosures that have not been proposed but that will be useful are the specific disclosure requirements related to ceded premiums, and ceded claims and expenses, as it relates to modified measurement approach.

Question 32 – Additional Question for Respondents

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 to 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.

We think the most appropriate improvement would be for FASB to pursue an approach based on the IASB's Exposure Draft with some changes. The nature of the required changes is discussed within the responses to other questions within this comment letter. We have highlighted some of the key changes below:

- For short-duration property & casualty contracts, discounting should not be required. Please refer to question 12 for details.
- Onerous contract liability should be simplified. The method should be similar to the premium deficiency tests currently deployed in various countries. Please refer to question 19 for details.
- Reinsurance contracts should follow the same accounting approach as the underlying direct insurance contract. Please refer to question 27 for details.
- The criteria utilized for eligibility for modified measurement approach requires changes. FASB should consider referring to the "contract boundary" instead of "coverage period" within the eligibility criteria. Another alternative is to utilize the eligibility criteria similar to the one described within FAS 60 for short-duration contracts. Please refer to question 21 for details.
- Pre-claims liability should only be unearned premiums (rather than unearned premiums incremental acquisition costs). Please refer to question 13 for details.
- Incremental acquisition costs should be presented as a separate line item on the balance sheet. Please refer to question 19 for details.
- For claims liability calculation, FASB should allow utilization of best estimate rather than the current IASB requirement of probability weighted cash flows. Please refer to question 7 for details.
- More guidance is required on the liquidity adjustment portion of the risk adjustment. Please refer to question 9 for details.
- No interest should be accreted on composite margin or residual margin. Please refer to question 17 for details.
- Proposed IASB ED presentation requirements need improvements. Please refer to question 19 for details.
- Proposed IASB ED disclosure requirements need improvements. Please refer to question 31 for details.