

December 15, 2010

Leslie F. Seidman, Acting Chairman c/o Technical Director Financial Accounting Standards Board 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Sent via e-mail to: director@fasb.org

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

Dear Ms. Seidman:

On behalf of The Northwestern Mutual Life Insurance Company ("Northwestern Mutual"), we are pleased to offer our comments and perspective on the Financial Accounting Standards Board's ("FASB") discussion paper (DP) entitled *Preliminary Views on Insurance Contracts*.

Northwestern Mutual, headquartered in Milwaukee, Wisconsin USA, was founded in 1857 and today is the country's largest direct provider of individual life insurance and the 10th largest life insurance group based on total assets. We offer our policy owners a full array of life insurance products, including permanent participating whole life, term and universal life. In addition, we offer annuities, disability and long-term care insurance. Our company continues to earn the highest available ratings for financial strength from each of Standards & Poor's, Moody's Investor Services, Fitch Ratings and A.M. Best.

Our Primary Business - Participating Life Insurance

It is critical to Northwestern Mutual that the accounting standards allow for the accurate representation of the long term nature of our business and the resulting economics. Our traditional participating whole life policy is a long term product. It is common for a policy owner to keep this product in force for the entire remaining life of the insured. We currently have approximately 100 policies on our books that were issued in the 1920s.

The participating nature of traditional whole life means that our policy owners share the risks of the contract with other policy owners. Policy dividends are annually determined amounts of surplus that are no longer needed by the company as protection for unforeseen risks. This means that the cost of the product is not guaranteed (except in extreme situations) and can be adjusted to reflect conditions at the time the dividend is to be paid. Participating dividends and other non-guaranteed policy elements function as a risk reduction mechanism for a mutual insurer. They reduce the risk to Northwestern Mutual associated with these policies and make the dividend payments an integral part of the liability of Northwestern to its policy owners.

As a mutual insurer we essentially offer our insurance to policy owners at cost. Our premium levels, modest guarantees coupled with the expectation that dividends will be paid, make the policies cost competitive over the long term.

Value for the policy owner arises from combining insurance and other guarantees at a cost determined by actual investment returns, claims and expense experience. This cannot be duplicated by assembling separately purchased components. The participating whole life product is a combination of benefits, all of which are dependent on one-another. The death benefit and cash surrender benefit are key elements of the policy, but only one of these benefits can be paid in full on a particular policy. If the cash surrender benefit has been fully paid, the death benefit is no longer available. Once the death benefit is paid, the cash surrender benefit is no longer available. The policy owner's usage of benefits in the policy is affected by the presence of other benefits. For example, the policy owner considering taking some of the cash surrender benefit will consider the resulting reduced death benefit. The interrelationship of the benefits influences if and the extent to which the benefits in the policy are used.

Overview

We encourage the Board to pursue its objective of a high quality converged insurance contracts standard. The building block approach described in the DP is a single model for all long-term insurance contracts in contrast to the three models in current US Generally Accepted Accounting Principles (GAAP). If properly developed and applied, the building block approach would be an improvement over US GAAP. As one model versus three the building blocks would be more understandable to financial statement readers. The periodic updating of assumptions and its general flexibility should enable the model to accurately reflect the economics of all long-term insurance liabilities. The disclosure of margin release outlined in the DP is meaningful information that is not currently disclosed under US GAAP. With some notable exceptions highlighted below, we generally support the conceptual elements reflected in the DP, particularly the building blocks applied to the fulfillment cash flows used to measure the insurance liability. The DP requires refinement and clarification in the following critical areas in order for it to be an improvement over US GAAP and justify the cost of change:

- Discount rates Due to a lack of specificity in the DP, we are concerned that a company like ours may be precluded from reflecting all of the risks inherent in the insurance liability. We have included suggestions on discount rate specifics.
- Measurement of the insurance obligation Balancing cost and precision should be explicitly permitted in the standard. Otherwise, there will be a tendency to use overly sophisticated and expensive techniques with little incremental benefit.
- Margin(s) We support the Board's preference for a composite margin. However, the measurement and runoff of the margin present concerns including the need to allow for an amortization consistent with policy economics, which we explain further.
- Financial statement presentation The exclusion of premiums and benefits from the operating statement would misrepresent the compensatory nature of those transactions. We provide a suggestion in this regard.

The DP embodies a significant degree of uncertainty and expense for companies like Northwestern who operate in a large mature insurance market with existing standards for financial reporting. Since the DP was released for comment in September, we have noted the wide range of interpretation of its provisions and those of the similar International Accounting Standards Board (IASB) exposure draft entitled

Insurance Contracts. If clarity isn't improved in the final standard the relevance, reliability and consistency of the resulting financial reporting will be deficient. To avoid such an outcome, both Boards should incorporate all appropriate changes to their respective proposals arising from this most recent public comment period, take the time necessary to publish a converged standard and then subject that standard to a final round of field testing before adoption. This will apply a higher level of quality assurance to the standard; in particular identifying reporting which does not accurately represent the actual economics of an insurance portfolio.

In addition, the development of procedures for periodic re-measurement of all insurance cash flows, the development of discount rates, the estimation of margins and their method of runoff, and the presentation of the balance sheet and operating statement will require substantial time and resources. Therefore, the transition period between adoption and the effective date must be long enough to allow companies and auditors time to reach conclusions on and implement measurement and other requirements. We recommend a minimum of three years.

Discount Rates

When applying the discounted cash flow approach provided in the DP, determining the appropriate discount rates is fundamental to fairly presenting the value of insurance liabilities.

We have concerns about the determination of the discount rates. The DP calls for the use of risk free rates plus an adjustment for liquidity. The adjustment for liquidity has been a significant source of confusion among preparers and auditors. Since there is no active market for the purchase and sale of insurance liabilities, the liquidity adjustment should be significant. The DP should provide more complete guidance as to the computation of this significant element of the discount rates.

Furthermore, the foundation of Northwestern's insurance policy design is the sharing of risk with and among policy owners. Northwestern policy owners do not participate on a risk free basis so a discount rate higher than the risk free rate plus a liquidity adjustment is appropriate. However, a lack of specificity in the final standard may preclude a company like ours from reflecting the risks borne by policy owners in the measurement of the insurance liability thus undermining the fair presentation of those liabilities. The final standard should provide that the discount rates must reflect the degree of risk sharing between the policy owner and the company. This will require discount rate development for specific portfolios of insurance liabilities.

The definition of the discount rate should be made inclusive enough to capture all of the risks inherent in the obligation. The risks associated with making investments, underwriting, incurring and managing expenses, and general business conditions affect the insurance contract cash flows and therefore should be reflected in the discount rates.

Insurance Obligation - Present Value of All Future Cash Flows

The accounting model proposed in the DP is a principles-based one-size-fits-all solution for a very extensive array of insurance products in multiple jurisdictions. This requires the model to be more general in nature and necessarily leaves substantial room for interpretation. It must also be flexible enough to accommodate all expected cash flows including policy dividends, claims, expenses and investment performance in the measurement of the insurance liability.

The standard should more clearly and prominently state that the sophistication and cost of techniques used for estimating the future cash flows should be commensurate with the actual variability of the cash flow component being measured (e.g. dividends, lapses, claims, expenses and investment returns). In this way management can determine the technique which produces the most accurate and timely measurement on a cost effective basis. The topic of balancing cost and precision should be prominently placed and explicitly permitted in the final standard; otherwise there will be a tendency to use overly sophisticated and expensive techniques when little incremental accuracy may be achieved. Worse yet, the use of such techniques may lead the user of the financial statements to believe that management has achieved a level of precision that is illusory.

Margin(s)

We support the Board's preference for a composite margin. In our view, the gain or loss from an insurance contract is the result of an earnings process that plays out over time as the policy owner pays premium to compensate the insurer and in turn is protected during the coverage period. A gain or loss recorded upon the issuance of the policy is inconsistent with the actual unfolding of the economic results of the transactions which occur with the passage of time. That said, we understand and support the prohibition on gain at issuance (consistent with today's US accounting model) and therefore the need for a margin adjustment that balances the present value of net cash flows. The margin should be recognized in income consistent with the unfolding economics of the insurance contract which occurs over the life of the policy.

The DP provides risk adjustment measurement guidance that is too detailed and may preclude the use of measurement techniques that are consistent with evolving pricing, design and management of a portfolio of insurance.

We also note that the size of the composite margin will be overstated because certain items that are important to the pricing of insurance products are not included in the cash flows allowed to be used in the calculation of insurance obligations. The DP does not allow expected cash flows to include certain costs that do not relate directly to the contract or contract activities, such as general overheads and certain acquisition costs. Excluding these cash flows for financial statement valuation, when they are specifically included in product design and pricing, results in a composite margin that does not fully reflect the economic design of the insurance contract. We suggest that the final standard allow the inclusion of the indirect costs currently not included in the cash flows used in calculation of the liability.

Financial Statement Presentation

Users of Northwestern's financial statements primarily concern themselves with the financial strength of the company evidenced mainly by our ability to pay claims, other obligations and dividends.

To assure that this fundamental information need continues to be met, the ability of the insurer to pay guaranteed and other future benefits should be evidenced by the accumulation of sufficient equity capital to absorb unanticipated changes to investment, claim, expense or general business circumstances. This capital is the difference between the assets of the insurer and an insurance liability representing the present value of the best estimate of the anticipated future cash flows under the contract.

The financial reporting which results from the building block approach applied to the fulfillment cash flows satisfies this information need only when the building blocks reflect the economics as assumed in policy pricing and design.

The collection of premium and payment of benefits is of paramount importance to the ongoing relationship between the insurer and policy owners and should be prominently reflected in the operating statement. Premiums and benefits are neither deposits nor a return of deposits. Premiums are compensation for insurance protection and are not returned at a later date after the protection period ends. Claim payments are compensation for covered losses and may greatly exceed the premiums paid on the policy. That said, we agree that the sources of material changes in the insurance liability should be reflected in the operating statement. We therefore support the "premiums written" approach highlighted within the DP where the statement of comprehensive income includes premiums and claims. In addition to being conceptually consistent with the nature of premium and benefit payments, this approach avoids incomparability when insurer revenues are compared with those of other capital market participants. Additional meaningful margin related information should be included within the footnote disclosures.

Relationship to Financial Instruments

As noted in previous comments to the Board, there is an integral relationship between the ultimate returns from a mutual life insurer's investments in financial instruments and the resources available to pay policy benefits, including participating dividends. In order to assure that the eventual accounting and financial reporting model for companies like ours is coherent overall and representative of the economics of our business, we strongly suggest that any implementation of significant change in accounting for financial instruments be deferred and coordinated with the ongoing *Insurance Contracts* project. Piecemeal implementation of changes that do not acknowledge this integral relationship risk the result of an accounting model that is inconsistent with the interests of our policy owners, regulators, creditors and other stakeholders.

Responses to the specific questions asked in the DP are in the appendix to this letter.

We appreciate the opportunity to comment on your Board's important and ongoing development of a standard for the accounting for insurance contracts. We would welcome an opportunity for further dialog, especially for those matters that are of particular importance to mutual life insurers.

Please contact Mr. Walter Givler (<u>wallygivler@northwesternmutual.com</u>) if we can be of service to the Board during future work on this project.

Sincerely,

Michael G. Carter

Vice President and Chief Financial Officer

Michael & Carter

David R. Remstad

WaltuM.

Vice President and Chief Actuary

David R. Remstad

John C. Kelly Vice President and Controller Walter M. Givler Vice President, Accounting Policy

Attachment: Northwestern Mutual's Comment Letter to the IASB on Insurance Contracts dated

November 30, 2010

Appendix - Responses to the Questions for Recipients Contained in the Proposal

Definition and Scope

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

Yes. We believe the definitions of *insurance contract* and *insurance risk* and related guidance within the proposed standard are sufficiently understandable and operational.

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?

Yes. We believe it is more appropriate to base the insurance accounting guidance on insurance contracts rather than insurance entities to enhance comparability for all insurance products whether or not they are issued by an insurance company.

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

Yes. While the scope exclusions potentially meet the definition of an insurance contract (e.g., warranties, employers' assets and liabilities under employee benefit plans, etc.), we believe they are uniquely different from the intent of the proposed insurance contracts standard and are more appropriately addressed within the guidance that has evolved over time for both their specific measurement and reporting.

- 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?
 - No. We believe these benefits are more akin to compensation and self-insurance and therefore are a situation that is uniquely different from the intent of the proposed insurance contracts standard and is more appropriately addressed within the guidance that has evolved over time for its specific measurement and reporting.
- 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?
 - Yes. The stated scope of the proposed insurance contracts standard is based on the definition of an insurance contract rather than the type of entity issuing the contract. We understand that financial instruments with discretionary participation features do not include insurance risk and therefore would be more appropriately addressed within the guidance on financial instruments.
- 6. Do you support the approach for determining when noninsurance components of contracts should be unbundled? Why or why not?

Yes. We agree it is only appropriate to unbundle components of an insurance contract related to unit-linked contracts and embedded derivatives and contractual terms relating to goods and services that are not closely related to the insurance coverage. However, significant confusion exists among constituents surrounding the unbundling requirements of the proposed standard and how unbundling would be implemented, if required. Our interpretation of the proposed guidance is that cash balances associated with common life insurance products such as non-variable whole life and universal life, policy loans, guaranteed minimum benefits (oftentimes referred to as GMXBs), or other similarly closely related contract features would not require unbundling. All of these elements are an integral part of the life insurance contract and cannot be designed or purchased separately. A requirement to unbundle these elements would result in arbitrary and non-economic valuation and reporting. We believe further clarification, with examples of common insurance features that do not require unbundling, should be provided within the final standard in order to eliminate confusion and to provide additional guidance on implementation when unbundling is required.

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?
 - No. While a probability-weighted estimate of net cash flows often yields a theoretically sound measurement of an insurance contract, there are many situations where the central estimate provides the best measurement. The proposed standard notes that certain situations will require relatively simple modeling and certain situations will require more sophisticated stochastic modeling. We believe that the majority of our long-term insurance obligations can be fairly determined without resorting to sophisticated stochastic modeling and that the stochastic modeling of our cash flows would likely require knowledge of distributions that do not exist. We are concerned that "industry practice" may develop that requires stochastic modeling with unnecessary expense to insurers and their policy owners. We believe additional clarification on when stochastic modeling is or is not required should be incorporated into the final standard with additional latitude in the measurement techniques allowed, as the stated approach is only one of many ways to achieve the measurement objective. The use of probability-weighted estimate of net cash flows in and of itself is not an improvement over existing U.S. GAAP. An improvement over existing U.S. GAAP is only achieved if the building block approach in aggregate is further developed and properly applied. The building blocks should fully reflect the economics of pricing and design. As it is a significant and fundamental departure from existing guidance, we believe the proposed methodology will only be an improvement if ample due process is afforded to address industry concerns and to ensure there is sufficient field testing to resolve the practical constraints identified.
- 8. Do you think that an entity's estimate of the net cash flows should include a risk adjustment margin?
 - No. We support the use of a single composite margin. The division of the composite margin (i.e., the amount calibrated to provide no gain at inception) into a risk and residual margin, while potentially conceptually appealing, implies a degree of precision that does not exist. The residual margin is further rendered less meaningful by the exclusion of certain cash outflows in the initial measurement of the insurance contract liability. For participating products, there is no theoretical support for the concept of a residual margin because any such margin is eventually passed on to the policy owners. The constraints imposed by the three allowable methods for determining the risk margin also may

result in a residual margin that is inconsistent with the economics of pricing and design. We therefore believe the creation of a separate risk and residual margin unnecessarily complicates measurement and reporting and will not produce additional relevant information for the users of an insurance company's financial statements with regards to making economic decisions.

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?

No. If the final standard requires the two-margin approach, we believe that this statement of the measurement objective for the risk margin needs clarification through restatement. The risk that the ultimate fulfillment cash flows *exceed* those expected should be restated as the risk that the ultimate fulfillment cash flows *differ from* those expected. We believe that this clarifies the intent to be consistent with discussion elsewhere in the exposure draft.

Methods for determining risk have become more sophisticated through time and will undoubtedly continue to evolve. We therefore do not believe it is appropriate to limit the determination of risk to the three techniques included within the DP. With regard to the cost of capital method, the guidance describes an approach to determining the capital level which is more consistent with regulatory minimum capital levels than with the much larger capital levels that most insurers actually hold; and we believe that the cost of capital is most appropriately measured with reference to the level of capital typically held.

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

No. We believe the measurement of the risk adjustment margin will not necessarily be comparable for entities that are exposed to similar risks. Entities view risk differently and different methods are available to determine that risk. Worse, financial pressures may influence an entity's arbitrary risk calculation whereas the composite margin is objectively determinable.

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?

No. The proposed standard disallows certain cash outflows (i.e., costs that do not relate directly to the contract or contract activities, such as general overheads, and non-incremental acquisition costs) that are included in the economic pricing and design of the insurance contract. The exclusion of such cash outflows in the initial measurement of an insurance contract will result in the initial and ongoing reporting of a margin that differs from the economics as contemplated by the insurer. All cash outflows as contemplated in the design and pricing of insurance should be included in measurement in order to faithfully represent the insurance liability. The disallowance of "arbitrary" cash flows from the measurement of an insurance contract significantly detracts from the theoretically sound building blocks approach as otherwise contemplated in the DP.

Yes. While we disagree with the "arbitrary" disallowance of certain cash flows from the measurement of an insurance contract, we believe the proposed guidance is operational from the standpoint of determining which cash flows are or are not allowed to be used.

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?

Yes. We agree that the carrying amount of all insurance contracts should be discounted if the effect is material. However, we do not believe the discounting of short-term insurance contracts (less than a year) provides cost-beneficial information to the users of the financial statements.

Yes. We agree with the proposal to consider the characteristics of the contract, including timing, currency and liquidity. However, we view the guidance in paragraph 65 of the DP as too narrow in view, because it does not consider all other characteristics of the contract. For example, some non-participating insurance contracts include non-guaranteed elements that introduce a degree of investment risk into the contract by making future cash flows depend partly on future interest rates. This characteristic of such contracts needs to be reflected in the discount rate through the addition of a spread that reflects the interest rate risk in the contract. Further, we have observed that the adjustment for liquidity has been a significant source of confusion among preparers and auditors. Since there is no active market for the purchase and sale of insurance liabilities, we would expect the liquidity adjustment to be significant. The guidance in the proposed standard should provide more complete guidance as to the computation of this significant element of the discount rate.

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?

Yes. Acquisition costs are included in the economic pricing and design of the insurance contract. See also our response to question 14 below.

- 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?
 - No. All acquisition costs are included in the economic pricing and design of the insurance contract. The exclusion of such cash outflows in the initial measurement of an insurance contract will result in the initial and ongoing reporting of a margin that differs from the economics as contemplated by the insurer. All cash outflows as contemplated in the design and pricing of insurance should be included in measurement in order to faithfully represent the insurance liability. The disallowance of "arbitrary" cash flows from the measurement of an insurance contract significantly detracts from the theoretically sound building blocks approach as otherwise contemplated in the DP.
- 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?

We support the use of a single composite margin. The division of the composite margin (i.e., the amount calibrated to provide no gain at inception) into a risk and residual margin, while potentially conceptually appealing, implies a degree of precision that does not exist. The residual margin is further rendered less meaningful by the exclusion of certain cash outflows in the initial measurement of the insurance contract liability. For participating products, there is no theoretical support for the concept of a residual margin because any such margin is eventually passed on to the policy owners. The constraints imposed by the three allowable methods for determining the risk margin also may result in a residual margin that is inconsistent with the economics of pricing and design. We therefore believe the creation of a separate risk and residual margin unnecessarily complicates measurement and reporting and will not produce additional relevant information for the users of an insurance company's financial statements with regards to making economic decisions. The composite margin only faithfully represents the economics of the insurance contracts if all of the building blocks are not constrained and are consistent with the actual economics of the insurance product. An improvement over existing U.S. GAAP is only achieved if the building block approach in aggregate is further developed and properly applied. As it is a significant and fundamental departure from existing guidance, we believe the proposed methodology will only be an improvement if ample due process is afforded to address industry concerns and to ensure sufficient field testing to resolve practical constraints identified.

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?

No. While the proposed method of the FASB (premium allocated to current period + current period claims and benefits / total contract premium + total claims and benefits) would provide a reasonable pattern of release in many cases, we do not believe the method of release should be constrained by a single formulaic method as it will not produce reasonable results in all situations. The allowance of a single prescribed formula is not a principle based approach. We believe other methods should be allowed if the proposed method of release does not follow the economics of the insurance contract.

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

Yes. The composite margin is essentially a "plug" to provide for no gain at inception. The accretion of interest adds unwarranted complexity to the formulaic and somewhat arbitrary release of the margin while providing little, if any, additional decision useful information to the users of the financial statements. In addition, it delays the release of margin in a way that is inconsistent with the pricing and economics of the contract.

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?

We believe there should be one approach for the measurement of an insurance contract liability. For short-term contracts the current U.S. GAAP unearned premium reserve methodology provides a reasonable approximation of the proposed standards stated objective and should be allowed as a proxy. By allowing but not requiring the unearned premium reserve methodology, insurers of both long and short duration contracts could choose to measure all their contracts in a consistent manner while allowing property and casualty insurers the use of the unearned premium reserve methodology

which may be more appropriate for their business. The modified approach needlessly over-complicates the unearned premiums reserve methodology with required discounting and other requirements.

19. 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)?

See our response to question 18. Specifically related to incremental acquisition costs, we believe that they should reduce the pre-claims obligation as contemplated under the modified approach consistent with the IASB ED.

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?

Yes, in general. However, we believe that more relevant and decision-useful information will be provided if the building block approach is further developed and properly applied. The building blocks should fully reflect the economics of pricing and design. As it is a significant and fundamental departure from existing guidance, we believe the proposed methodology should be afforded ample due process to address industry concerns and to ensure sufficient field testing to resolve practical constraints identified. We believe the discounting of the unearned premium reserve does not provide relevant and decision-useful information for short-duration contracts.

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)?

An unearned premium reserve methodology should be allowed but not required (see our response to question 18). We believe it should be restricted to a coverage period of approximately 12 months or less as contemplated in the IASB ED. For periods greater than 12 months, it is difficult to argue that discounting is not material.

- 22. Are there specific types of insurance contracts for which the approaches would not provide decision-useful information?
 - No. Not for the insurance products of Northwestern Mutual.
- 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?

We have not provided an answer to this question as it is not particularly relevant to our business and related financial reporting.

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

We have no additional comments.

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

We estimate the costs of implementing the proposed standard to be in the range of USD 15 - 25 million as implementation will include substantial systems development. We estimate the additional ongoing costs at between USD 1-3 million per year.

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?

Yes. Insurance contracts held directly by other policyholders should be excluded from the Insurance Contracts standard. The accounting is more appropriately addressed within the guidance that has evolved over time for both its specific measurement and reporting.

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

Yes. We support the expected loss model as it is consistent with the fulfillment approach proposed for the measurement of the underlying insurance contracts. We agree with the underlying intent and approach of the proposed reinsurance guidance and believe it is workable for our relatively straightforward reinsurance arrangements. However, we note that industry is concerned with the minimal guidance provided and how it applies to a wider range of more complicated and sophisticated reinsurance arrangements. We believe these concerns should be contemplated and addressed in the final standard.

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.

No. Premiums are not deposits and claims are not return of deposits. Premiums are compensation for insurance protection and are generally not returned at a later date after the protection period ends. Benefit payments are compensation for covered losses and may greatly exceed the premiums paid on the policy. The collection of premiums and payment of benefits is of paramount importance to the ongoing relationship between the insurer and policy owner and are the primary cash flows under the building blocks measurement approach. As changes in this measurement drive performance,

premiums and claims should not be relegated to the financial statement footnotes but prominently displayed in the operating statement. We therefore believe the disclosure requirements within the proposed standard which include a reconciliation of opening to closing aggregate contract balances, are the proper place to highlight the changes in the insurance liability.

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)?

We support the "premiums written" approach highlighted within paragraphs 118 and 119 of the FASB's Discussion Paper where the statement of comprehensive income includes premiums and claims. We believe additional meaningful margin related information should be included within the footnote disclosures.

30. 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?

See our responses to questions 28 and 29.

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?

Yes, in general. We agree that insurers should disclose both qualitative and quantitative information about the amounts recognized in its financial statements and the nature and extent of risks arising from the insurance contracts. We believe the disclosure requirements within the proposed standard which include a reconciliation of opening to closing aggregate contract balances, will meet the proposed objective.

For reasons previously articulated throughout our response, we do not believe the division of the composite margin into separate risk and residual margins provides additional useful (and potentially misleading) information and we therefore do not believe the disclosures surrounding the risk and residual margins would be beneficial to users of financial statements. We are also concerned that the requirement to disclose methods and inputs used to determine estimates of policyholder dividends, if too detailed, would result in the disclosure of information considered proprietary.

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 to U.S. GAAP?
 - a. Pursue an approach based on the IASB's Exposure Draft? No.
 - b. Pursue an approach based on the IASB's Exposure Draft with some changes? Please explain those changes. No.
 - c. Pursue an approach based on the Board's preliminary views in this Discussion Paper? No.

d. Pursue an approach based on the Board's preliminary views in this Discussion Paper with some changes? Please explain those changes. Yes.

Current US GAAP has evolved incrementally over time and has developed into a high quality and workable model. However, for long-term insurance contracts, it utilizes three distinct models in FAS 60, FAS 97 and FAS 120. The building block approach utilizes a single model for all long-term insurance contracts. We believe the building block approach, if properly developed and applied, is an improvement over US GAAP. Theoretically, it is flexible enough to capture the economics of all long-term insurance liabilities. As one model with periodic updating of assumptions it is more internally consistent and current. Further, the disclosure of margin release is meaningful and decision useful information that is not currently disclosed under US GAAP.

However, as the building block approach is a significant and fundamental departure from existing guidance, the proposed methodology as contemplated in the IASB ED and FASB DP needs further development. While we believe it is theoretically superior to current US GAAP, it will only be an improvement if ample due process is afforded to address valid industry concerns and to ensure sufficient field testing performed to resolve the practical constraints identified. Additionally, the FASB needs so ensure that the Insurance Contracts standard aligns with the Financial Instruments standard and is converged with the IASB. Only then will the benefits justify the significant costs of implementation.

e. Make targeted changes to address specific concerns about current U.S. GAAP (for example, items included in paragraph 7)? Please describe those changes. No.



November 30, 2010

Sir David Tweedie, Chair International Accounting Standards Board 30 Cannon Street London EC4M 6XH, United Kingdom

Re: Insurance Contracts Exposure Draft (ED)

Dear Sir David Tweedie:

On behalf of The Northwestern Mutual Life Insurance Company ("Northwestern Mutual"), we are pleased to offer our comments and perspective on the International Accounting Standards Board's ("IASB") exposure draft entitled *Insurance Contracts*.

Northwestern Mutual, headquartered in Milwaukee, Wisconsin USA, was founded in 1857 and today is the country's largest direct provider of individual life insurance and the 10th largest life insurance group based on total assets. We offer our policy owners a full array of life insurance products, including permanent participating whole life, term and universal life. In addition, we offer annuities, disability and long-term care insurance. Our company continues to earn the highest available ratings for financial strength from each of Standards & Poor's, Moody's Investor Services, Fitch Ratings and A.M. Best.

Our Primary Business - Participating Life Insurance

It is critical to Northwestern Mutual that the accounting standards allow for the accurate representation of the long term nature of our business and the resulting economics. Our traditional participating whole life policy is a long term product. It is common for a policy owner to keep this product in force for the entire life of the insured. We currently have approximately 100 policies on our books that were issued in the 1920s.

The participating nature of traditional whole life means that our policy owners share the risks of the contract with other policy owners. Policy dividends are annually determined amounts of surplus that are no longer needed by the company as protection for unforeseen risks. This means that the cost of the product is not guaranteed (except in extreme situations) and can be adjusted to reflect conditions at the time the dividend is to be paid. Participating dividends and other non-guaranteed policy elements function as a risk reduction mechanism for a mutual insurer. They reduce the risk to Northwestern Mutual associated with these policies and make the dividend payments an integral part of the liability of Northwestern to its policy owners.

As a mutual insurer we essentially offer our insurance to policy owners at cost. Our premium levels, modest guarantees coupled with the expectation that dividends will be paid, make the policies cost competitive over the long term. For participating policies there is no theoretical basis for residual margin, as any residual is eventually returned to policy owners.

Value for the policy owner arises from combining insurance and other guarantees at a cost determined by actual investment returns, claims and expense experience. This cannot be duplicated by assembling separately purchased components. The participating whole life product is a combination of benefits, all of which are

dependent on one-another. The death benefit and cash surrender benefit are key elements of the policy, but only one of these benefits can be paid in full on a particular policy. If the cash surrender benefit has been fully paid, the death benefit is no longer available. Once the death benefit is paid, the cash surrender benefit is no longer available. The policy owner's usage of benefits in the policy is affected by the presence of other benefits. For example, the policy owner considering taking some of the cash surrender benefit will consider the resulting reduced death benefit. The interrelationship of the benefits influences if and the extent to which the benefits in the policy are used.

Overview

With some notable exceptions highlighted below, we generally support the conceptual elements reflected in the Exposure Draft (ED), particularly the building blocks applied to the fulfillment cash flows used to measure the insurance liability.

We feel that the ED requires refinement and clarification in the following critical areas:

- Discount rates Due to a lack of specificity in the ED, we are concerned that a company like ours may
 be precluded from reflecting all of the risks inherent in the insurance liability. We have included
 suggestions on discount rate specifics.
- Measurement of the insurance obligation Balancing cost and precision should be explicitly permitted
 in the standard. Otherwise, there will be a tendency to use overly sophisticated and expensive
 techniques with little incremental benefit.
- Margin(s) The measurement and runoff of risk and residual margins present several concerns
 including illusory precision and amortization inconsistent with policy economics, which we explain
 further.
- Financial statement presentation The exclusion of premiums and benefits from the operating statement misrepresents the compensatory nature of those transactions. We provide a suggestion in this regard.

The ED embodies a significant degree of uncertainty and expense for companies like Northwestern who operate in a large mature insurance market with existing standards for financial reporting. Since the ED was released for comment in July we have been struck by the wide range of interpretation of its provisions and the attendant confusion. If clarity isn't improved in the final standard the relevance, reliability and consistency of the resulting financial reporting will be deficient. To avoid such an outcome we feel that the IASB should incorporate all appropriate changes to the ED arising from this most recent public comment period and then subject the standard to a final round of field testing before adoption. This will apply a higher level of quality assurance to the standard; in particular identifying reporting which does not accurately represent the actual economics of an insurance portfolio.

In addition, the development of procedures for periodic re-measurement of all insurance cash flows, the development of discount rates, the estimation of margins and their method of runoff, and the presentation of the balance sheet and operating statement will require substantial time and resources. Therefore, the transition period between adoption and the effective date must be long enough to allow companies and auditors time to reach conclusions on and implement measurement and other requirements. We recommend a minimum of three years.

Discount Rates

When applying the discounted cash flow approach provided in the ED, determining the appropriate discount rates is fundamental to fairly presenting the value of insurance liabilities.

We have concerns about the determination of the discount rates. The ED calls for the use of risk free rates plus an adjustment for liquidity. We have observed that the adjustment for liquidity has been a significant source of confusion among preparers and auditors. Since there is no active market for the purchase and sale of insurance liabilities, we would expect the liquidity adjustment to be significant. The ED should provide more complete guidance as to the computation of this significant element of the discount rates.

Furthermore, the foundation of Northwestern's insurance policy design is the sharing of risk with and among policy owners. Northwestern policy owners do not participate on a risk free basis so a discount rate higher than the risk free rate plus a liquidity adjustment is appropriate. However, due to a lack of specificity in the ED, a company like ours may be precluded from reflecting the risks borne by policy owners in the measurement of the insurance liability thus undermining the fair presentation of those liabilities. The ED should be more clear that the discount rates should reflect the degree of risk sharing between the policy owner and the company. This will require discount rate development for specific portfolios of insurance liabilities.

The definition of the discount rate in the ED should be made inclusive enough to capture all of the risks inherent in the obligation. The risks associated with Northwestern making investments, underwriting, incurring and managing expenses, and general business conditions affect the insurance contract cash flows and therefore should be reflected in the discount rates.

Insurance Obligation - Present Value of All Future Cash Flows

The accounting model proposed in the ED is a principles-based one-size-fits-all solution for a very extensive array of insurance products in multiple jurisdictions. This requires the model to be more general in nature and necessarily leaves substantial room for interpretation. It must also be flexible enough to accommodate all expected cash flows including policy dividends, claims, expenses and investment performance in the measurement of the insurance liability.

The standard should more clearly and prominently state that the sophistication and cost of techniques used for estimating the future cash flows should be commensurate with the actual variability of the cash flow component being measured (e.g. dividends, lapses, claims, expenses and investment returns). In this way management can determine the technique which produces the most accurate and timely measurement on a cost effective basis. We note a reference to "without incurring considerable cost" in B38. However, we feel that the topic of balancing cost and precision should be more prominently placed and explicitly permitted in the standard; otherwise there will be a tendency to use overly sophisticated and expensive techniques when little incremental accuracy may be achieved. Worse yet, the use of such techniques may lead the user of the financial statements to believe that management has achieved a level of precision that is illusory.

Margin(s)

In our view, the gain or loss from an insurance contract is the result of an earnings process that plays out over time as the policy owner pays premium to compensate the insurer and in turn is protected during the coverage period. A gain or loss recorded upon the issuance of the policy is inconsistent with the actual unfolding of the economic results of the transactions which occur with the passage of time. That said, we understand and support

the prohibition on gain at issuance (consistent with today's US accounting model) and therefore the need for a margin adjustment that balances the present value of net cash flows. The margin should be recognized in income consistent with the unfolding economics of the insurance contract which occurs over the life of the policy.

The ED calls for the amount calibrated to provide for no gain at inception to be split into two components. One component is intended to represent a risk adjustment determined as the hypothetical amount the insurer would pay to be relieved of the risk that the cash flows necessary to fulfill the policy will be different than anticipated. The second component known as the residual margin is the amount necessary to produce no gain at the issuance of the contract. We believe that this splitting of the margins implies a degree of precision that does not exist. Regardless, the ED provides risk adjustment measurement guidance that is too detailed and may preclude the use of measurement techniques that are consistent with evolving pricing, design and management of a portfolio of insurance.

We also note that the size of the residual margin will be overstated because certain items that are important to the pricing of insurance products are not included in the cash flows allowed to be used in the calculation of insurance obligations. The ED specifically does not allow expected cash flows to include certain costs that do not relate directly to the contract or contract activities, such as general overheads and certain acquisition costs. Excluding these cash flows for financial statement valuation, when they are specifically included in product design and pricing, results in a residual margin that does not fully reflect the economic design of the insurance contract. This is particularly problematic for a mutual insurer where all such margin is eventually passed on to the policy owners. This results in the creation of a residual margin where none theoretically exists.

The size of the residual margin would not be an issue if the amortization was consistent with the economics of the insurance product but, in the ED, it is not. The ED amortizes this margin in proportion to the timing of the payment of benefits and accrues interest on the balance. This means that the margin actually increases in the early years and a majority of the balance is not amortized for many years. The split of the margin into two pieces may be more illusory than real. We suggest the Board use a single margin approach. Further, we suggest that the ED be modified to allow the inclusion of the indirect costs currently not included in the cash flows used in calculation of the liability.

Financial Statement Presentation

We have found through interaction with users of Northwestern's financial statements that they primarily concern themselves with the financial strength of the company evidenced mainly by our ability to pay claims, other obligations and dividends.

To assure that this fundamental information need continues to be met, the ability of the insurer to pay guaranteed and other future benefits should be evidenced by the accumulation of sufficient equity capital to absorb unanticipated changes to investment, claim, expense or general business circumstances. This capital is the difference between the assets of the insurer and an insurance liability representing the present value of the best estimate of the anticipated future cash flows under the contract.

We believe that the financial reporting which results from the building block approach applied to the fulfillment cash flows satisfies this information need only when the building blocks reflect the economics as assumed in policy pricing and design.

The collection of premium and payment of benefits is of paramount importance to the ongoing relationship between the insurer and policy owners and should be prominently reflected in the operating statement. Premiums and benefits are neither deposits nor a return of deposits. Premiums are compensation for insurance protection and are not returned at a later date after the protection period ends. Claim payments are compensation for covered losses and may greatly exceed the premiums paid on the policy. That said, we agree that the sources of material changes in the insurance liability should be reflected in the operating statement. We therefore support the "premiums written" approach highlighted within the FASB's Discussion Paper where the statement of comprehensive income includes premiums and claims. In addition to being conceptually consistent with the nature of premium and benefit payments, this approach avoids incomparability when insurer revenues are compared with those of other capital market participants. Additional meaningful margin related information should be included within the footnote disclosures.

Responses to the specific questions asked in the ED are in the appendix to this letter.

We appreciate the opportunity to comment on your Board's important and ongoing development of a standard for the accounting for insurance contracts. We would welcome an opportunity for further dialog, especially for those matters that are of particular importance to mutual life insurers.

Please contact Mr. Walter Givler (<u>wallygivler@northwesternmutual.com</u>) if we can be of service to the Board during future work on this project.

Sincerely,

Michael G. Carter

Vice President and Chief Financial Officer

Michael S. Conter

David R. Remstad

Vice President and Chief Actuary

WaltuM. Linker

David R. Remstad

John C. Kelly

Vice President and Controller

John C Willy

Walter M. Givler

Vice President, Accounting Policy

APPENDIX - Responses to the Questions for Recipients Contained in the Proposal

Question 1 – Relevant information for users

Do you think that the proposed measurement model will produce relevant information that will help users of an insurer's financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why?

Yes. If properly applied, we agree that a measurement model that includes all expected cash flows, including policy dividends, claims, expenses and investment performance where applicable, will produce relevant information that will help users of an insurance company's financial statements make economic decisions. However, as the proposed measurement model is a principles-based model that covers a very extensive array of insurance products, and necessarily leaves substantial room for interpretation, we believe practitioners will need sufficient latitude to implement the standard. This flexibility and coordination with the deliberations on the financial instruments standard are critical to providing relevant information to users of financial statements. See also our response to question 18.

Question 2 – Fulfillment cash flows

(a) Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?

Yes, but not necessarily as constrained by the proposed standard. The proposed standard disallows certain cash outflows (i.e., costs that do not relate directly to the contract or contract activities, such as general overheads, and non-incremental acquisition costs) that are included in the economic pricing and design of the insurance contract. The exclusion of such cash outflows in the initial measurement of an insurance contract will result in the initial and ongoing reporting of a residual margin that differs from the economics as contemplated by the insurer. All cash outflows as contemplated in the design and pricing of insurance should be included in measurement in order to faithfully represent the insurance liability.

(b) Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?

No. The proposed standard notes that certain situations will require relatively simple modeling and certain situations will require more sophisticated stochastic modeling. We believe that the majority of our long-term insurance obligations can be fairly determined without resorting to sophisticated stochastic modeling and that the stochastic modeling of our cash flows would likely require knowledge of distributions that do not exist. We are concerned that "industry practice" may develop that requires stochastic modeling with unnecessary expense to insurers and their policy owners. We believe additional clarification on when stochastic modeling is or is not required should be incorporated into the final standard with additional latitude in the measurement techniques allowed, as the stated approach is only one of many ways to achieve the measurement objective.

Ouestion 3 – Discount rate

(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

Yes. We would believe otherwise if the risk margin were intended to provide for any investment risk retained by the insurer, such as asset default risk. Since the risk margin does not reflect this risk, another means is needed to provide for the investment risk retained by the insurer. In our view, this is accomplished by an appropriate reduction of the discount rate to a level below the expected earned rate. The size of the reduction depends on the degree of investment risk retained by the insurer, if any. We believe this approach is consistent with paragraphs 30(a) and 30(b).

(b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?

Yes. We agree with the proposal to consider the characteristics of the contract, including timing, currency and liquidity. However, we view the guidance in paragraph 31 as too narrow in view, because it does not consider all other characteristics of the contract. For example, some non-participating insurance contracts include non-guaranteed elements that introduce a degree of investment risk into the contract by making future cash flows depend partly on future interest rates. This characteristic of such contracts needs to be reflected in the discount rate through the addition of a spread that reflects the interest rate risk in the contract. Further, we have observed that the adjustment for liquidity has been a significant source of confusion among preparers and auditors. Since there is no active market for the purchase and sale of insurance liabilities, we would expect the liquidity adjustment to be significant. The guidance in the proposed standard should provide more complete guidance as to the computation of this significant element of the discount rate.

(c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfillment cash flows should not reflect the risk of non-performance by the insurer?

Yes. We believe that these concerns are rooted in the narrow view expressed in paragraph 31. We would suggest that an equally valid interpretation of paragraph 30 would be to restate paragraph 31 as follows:

"As a result of the principle in paragraph 30, the discount rate for insurance contracts should be less than the expected earned rate on the insurer's assets by an amount that reflects the investment risk retained by the insurer and not passed on to the contract holder, if any."

Such a statement is consistent with the understanding that many insurance contracts pass significant liquidity risk, and sometimes other investment risks as well, to the contract holder. It is also consistent with the concept of a replicating portfolio as discussed in paragraph 34, since construction of a replicating portfolio would involve purchase of hedges to offset any retained investment risk, and purchase of such hedges would reduce the portfolio yield.

Question 4 – Risk adjustment versus composite margin

Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favours)? Please explain the reason(s) for your view.

We support the use of a single composite margin. The division of the composite margin (i.e., the amount calibrated to provide no gain at inception) into a risk and residual margin, while potentially conceptually appealing, implies a degree of precision that does not exist. The residual margin is further rendered less meaningful by the exclusion of certain cash outflows in the initial measurement of the insurance contract liability. For participating products, there is no theoretical support for the concept of a residual margin because any such margin is eventually passed on to the policy owners. The constraints imposed by the three allowable methods for determining the risk margin also may result in a residual margin that is inconsistent with the economics of pricing and design. We therefore believe the creation of a separate risk and residual margin unnecessarily complicates measurement and reporting and will not produce additional relevant information for the users of an insurance company's financial statements with regards to making economic decisions. This view is more fully expanded upon in our responses to questions 5 and 6.

Question 5 - Risk adjustment

- (a) Do you agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?
- No. If the IASB requires the two-margin approach, we believe that this statement of the measurement objective for the risk margin needs clarification through restatement. The risk that the ultimate fulfillment cash flows *exceed* those expected should be restated as the risk that the ultimate fulfillment cash flows *differ from* those expected. We believe that this clarifies the intent to be consistent with discussion elsewhere in the exposure draft.
- (b) Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. Do you agree that these three techniques should be allowed, and no others? Why or why not? If not, what do you suggest and why?
- No. Methods for determining risk have become more sophisticated through time and will undoubtedly continue to evolve. We therefore do not believe it is appropriate to limit the determination of risk to these three techniques.
- (c) Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90(b)(i))? Why or why not?
- No. If an insurer uses either the CTE or the cost of capital technique, we do not believe it is appropriate to disclose the confidence level to which the risk adjustment corresponds. Such disclosure would not provide decision-useful information because measurement of the confidence level can be very subjective, especially in situations where a different technique was used to set the risk margin. The resulting disclosures would not be comparable among insurers nor provide consistent and reliable information. Consistency is best achieved through clear statement of the measurement objective. In addition, this disclosure could require two separate calculations of the liability, considerably increasing the cost of financial reporting. Percentile methods and cost of capital methods are different enough that one cannot estimate a percentile based on the cost of capital calculation. Thus if the cost of capital method is used,

two calculations would be required. We also note that the requirement to disclose the percentile implies that this is the better calculation. We don't agree that this is the case and we don't think the Board intends to make this statement.

(d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (i.e. a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?

Yes, as long as an insurer is not constrained in determining the level of aggregation and the risk adjustment reflects its view of the economics used in pricing, design and managing its business.

- (e) Is the application guidance in Appendix B on risk adjustments at the right level of detail? Do you have any comments on the guidance?
- No. The application guidance in Appendix B provides too much detail and may not allow for the determination of risk in a manner that is consistent with economic pricing, design and management of a portfolio of insurance. We believe the risk measurement method should not be restricted to one of the three methods in the proposed standard as other methods are acceptable and the techniques used in risk measurement continue to evolve. With regard to the cost of capital method, the guidance describes an approach to determining the capital level which is more consistent with regulatory minimum capital levels than with the much larger capital levels that most insurers actually hold; and we believe that the cost of capital is most appropriately measured with reference to the level of capital typically held.

Question 6 – Residual/composite margin

- (a) Do you agree that an insurer should not recognise any gain at initial recognition of an insurance contract (such a gain arises when the expected present value of the future cash outflows plus the risk adjustment is less than the expected present value of the future cash inflows)? Why or why not?
- Yes. We agree that an insurer should not recognize any gain as a result of the initial measurement of an insurance contract. This is consistent with today's US accounting model and therefore will result in the need for a margin adjustment that balances the present value of net cash flows. Any "gain" should be recognized over the life of an insurance contract as the actual economics and performance that impact the obligations of the parties to the contract occur over time.
- (b) Do you agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognised immediately in profit or loss (such a loss arises when the expected present value of the future cash outflows plus the risk adjustment is more than the expected present value of future cash inflows)? Why or why not?
- Yes. If the IASB requires the two margin approach, we believe the residual margin should not be less than zero and a loss should be recognized immediately if that reflects the economics of the insurance contract. This is consistent with today's US accounting model and conservatively reflects an anticipated loss in the financial statements.
- (c) Do you agree that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period? Why or why not? If not, what do you recommend and why?

Yes, as long as an insurer is not constrained in determining the level of aggregation that reflects its view of the economics that is used in its pricing, design and managing of its insurance contracts.

(d) Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why (see paragraphs 50 and BC125–BC129)?

No. If the IASB requires the two margin approach, we agree that the residual margin should be released over time but do not believe that it should also be released on the basis of the expected timing of incurred claims and benefits if that pattern differs significantly from the passage of time. The expected timing of incurred claims and benefits are typically very back-ended for our long-term life insurance policies. As the residual margin can be viewed to represent a "deferred risk-adjusted profit", it is distinct from the pattern of cash flows and the risk under the insurance contract, both of which are already fully reflected in other aspects of the measurement. The residual margin should thus emerge along a pattern more closely aligned with the passage of time versus benefits incurred or paid. A run-off pattern based on incurred claims and benefits, especially when they are back-ended, combined with interest accretion on the residual margin (see also our response to question 6 (f) below) has the potential to create a residual margin that actually increases over time. This may result in reported "losses" for an extended period of time which do not remotely reflect the economics of financially sound insurance business.

(e) Do you agree with the proposed method(s) of releasing the composite margin, if the Board were to adopt the approach that includes such a margin (see the Appendix to the Basis for Conclusions)? Why or why not?

No. While the proposed method of the FASB (premium allocated to current period + current period claims and benefits / total contract premium + total claims and benefits) would provide a reasonable pattern of release in many cases, we do not believe the method of release should be constrained by a single formulaic method as it will not produce reasonable results in all situations.

(f) Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131–BC133)? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?

No. While in theory, the residual margin can be construed to be the present value of "deferred riskadjusted profit" where the accretion of interest would be appropriate, it can also lead to misleading results when other components of the building block method are not consistent with the economics of product pricing and design. Specifically, the exclusion of certain cash flows and the somewhat "arbitrary" nature of its determination through a constrained risk adjustment can result in an inappropriately large residual margin. An inappropriately large residual margin, combined with the proposed back-ended amortization pattern and the accretion of interest will result in an extremely distorted release of the residual margin. Specifically, for our long-term whole life participating insurance products, the creation of a residual margin where none theoretically exists, if combined with a risk determination that does not reflect the economics of pricing and design (i.e., risk determination is inappropriately reduced by the use regulatory minimum capital requirements thereby increasing the residual margin), a significant residual margin would result. Combined with the long-term and the back-ended nature of incurred claims and benefits (see also our response to question 6 (d) above), interest accretion would exceed residual margin "amortization" and the residual margin would actually increase for an extended period of time. This combined effect would result in reported losses and overstated reserves for many years and would not reflect the economics of this financially sound business. In summary, the accretion of interest adds unwarranted complexity to the release of the residual margin, and combined with other constraints imposed by the proposed standard, can lead to very misleading results. The theoretical accretion of interest is only appropriate when all building blocks are not constrained and are determined in accordance

with the actual economics of the insurance contracts. We therefore believe the release of the residual margin should be more closely aligned with the passage of time.

For similar reasons, we do not believe interest should be accreted on the composite margin.

Question 7 – Acquisition costs

(a) Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition costs should be recognised as expenses when incurred? Why or why not? If not, what do you recommend and why?

No. We believe all acquisition costs should be included in the initial cash outflows that are used in initial measurement to obtain consistency with the economic pricing and design of the insurance contracts. The exclusion of non-incremental acquisition costs from the cash outflows at initial measurement will result in the creation of a residual margin. For participating products, there is no theoretical support for the concept of a residual margin because any such margin is eventually passed on to the policy owners.

Question 8 – Premium allocation approach

(a) Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?

We have not provided an answer to this question as it is not particularly relevant to our business and related financial reporting.

(b) Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?

We have not provided an answer to this question as it is not particularly relevant to our business and related financial reporting.

Question 9 – Contract boundary principle

Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?

Yes. We believe the proposed boundary principle included within the proposed standard is sufficiently clear and workable so as to provide consistency in practice.

Question 10 – Participating features

(a) Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?

Yes. We welcome the proposed guidance and its recognition of participating benefits as an integral feature of many insurance contracts and welcome their explicit inclusion in the probability weighted cash

flows for measurement. The exclusion of these participating benefits in measurement would result in a reported value extremely divergent from economic substance. With that said, we do not understand the meaning of "payments to future policyholders" included within paragraph B61(j) and believe the words "or future" should be stricken from that paragraph.

(b) Should financial instruments with discretionary participation features be within the scope of the IFRS on insurance contracts, or within the scope of the IASB's financial instruments standards? Why?

No. The stated scope of the proposed insurance contracts standard is based on the definition of an insurance contract rather than the type of entity issuing the contract. We understand that financial instruments with discretionary participation features do not include insurance risk and therefore would be more appropriately addressed within the guidance on financial instruments.

Question 11 – Definition and scope

(a) Do you agree with the definition of an insurance contract and related guidance, including the two changes summarised in paragraph BC191? If not, why not?

Yes. We believe the proposed definition of an insurance contract and related guidance included within the proposed standard is sufficiently clear and workable.

(b) Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?

Yes. While scope exclusions potentially meet the definition of an insurance contract (e.g., warranties, employers' assets and liabilities under employee benefit plans, etc.), we believe they are uniquely different from the intent of the proposed insurance contracts standard and are more appropriately addressed within the guidance that has evolved over time for both their specific measurement and reporting.

(c) Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?

Yes. These financial guarantees meet the definition of insurance and therefore we believe they are more appropriately accounted for under the insurance contracts standard than under the financial instruments standard.

Question 12 - Unbundling

Do you think it is appropriate to unbundle some components of an insurance contract? Do you agree with the proposed criteria for when this is required? Why or why not? If not, what alternative do you recommend and why?

Yes. We agree that it is appropriate to potentially unbundle some components of an insurance contract.

Yes. We agree it is only appropriate to unbundle components of an insurance contract related to unitlinked contracts and embedded derivatives and contractual terms relating to goods and services that are not closely related to the insurance coverage. However, significant confusion exists among constituents surrounding the unbundling requirements of the proposed standard and how unbundling would be implemented, if required. Our interpretation of the proposed guidance is that cash balances associated with common life insurance products such as non-variable whole life and universal life, policy loans, guaranteed minimum benefits (oftentimes referred to as GMXBs), or other similarly closely related contract features would not require unbundling. All of these elements are an integral part of the life insurance contract and cannot be designed or purchased separately. A requirement to unbundle these elements would result in arbitrary and non-economic valuation and reporting. We believe further clarification, with examples of common insurance features that do not requiring unbundling, should be provided within the final standard in order to eliminate confusion and to provide additional guidance on implementation when unbundling is required.

Question 13 – Presentation

(a) Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?

No. Premiums are not deposits and claims are not return of deposits. Premiums are compensation for insurance protection and are generally not returned at a later date after the protection period ends. Benefit payments are compensation for covered losses and may greatly exceed the premiums paid on the policy. The collection of premiums and payment of benefits is of paramount importance to the ongoing relationship between the insurer and policy owner and are the primary cash flows under the building blocks measurement approach. As changes in this measurement drive performance, premiums and claims should not be relegated to the financial statement footnotes but prominently displayed in the operating statement. We therefore support the "premiums written" approach highlighted within the FASB's Discussion Paper where the statement of comprehensive income includes premiums and claims. Additional meaningful margin related information should be included within the footnote disclosures.

(b) Do agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

It depends on the final form of the proposed financial instruments standard. We believe the finalization of the insurance contracts standard should be coordinated with the deliberations on the financial instruments standard in order to avoid misleading insurer reporting during the both transition periods and on a longer term basis. We encourage consistent measurement techniques under both standards to prevent volatility that arises solely from different accounting measurement models. If the standards are properly aligned, and changes in reported asset values are reported in profit or loss, we agree that all income and expense arising from insurance contract measurement should also be reported in profit or loss. If the standards are not aligned and financial assets are reported at either fair value through other comprehensive income or amortized cost, we believe it would be appropriate to reflect changes in the insurance contract obligation that are attributable to the change in the discount rate in other comprehensive income as well.

Question 14 – Disclosures

(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

Yes. We agree that insurers should disclose both qualitative and quantitative information about the amounts recognized in its financial statements and the nature and extent of risks arising from the insurance contracts.

(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

Yes. We believe the disclosure requirements within the proposed standard which include a reconciliation of opening to closing aggregate contract balances, will meet the proposed objective.

(c) Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

Yes. For the reasons previously articulated throughout our response, we do not believe the division of the composite margin into separate risk and residual margins provides additional useful (and potentially misleading) information and we therefore do not believe the disclosures surrounding the risk and residual margins would be beneficial to users of financial statements. We are also concerned that the requirement to disclose methods and inputs used to determine estimates of policyholder dividends, if too detailed, would result in the disclosure of information considered proprietary.

Question 15 – Unit-linked contracts

Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?

Yes. We generally agree with the proposal for unit-linked contracts. While we believe we understand and agree with the Board's intent, the interaction with IFRS 9 is not sufficiently clear. The final standard should clarify that the assets are to be reported as a single line item notwithstanding any requirement of IFRS 9 which would potentially require the breakout and separate reporting of the underlying assets of unit-linked contracts.

Ouestion 16 – Reinsurance

(a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?

Yes. We support the expected loss model as it is consistent with the fulfillment approach proposed for the measurement of the underlying insurance contracts.

(b) Do you have any other comments on the reinsurance proposals?

We agree with the underlying intent and approach of the proposed reinsurance guidance and believe it is workable for our relatively straightforward reinsurance arrangements. However, we note that industry is concerned with the minimal guidance provided and how it applies to a wider range of more complicated and sophisticated reinsurance arrangements. We believe these concerns should be contemplated and addressed in the final standard.

Question 17 – Transition and effective date

(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?

No. We believe the proposed transition requirements should allow for retrospective application. Specifically, we believe it is appropriate that the transition guidance allow for the establishment of an appropriate margin, either a composite margin or a combination of a risk and a residual margin for all insurance in force at the time of transition. Not allowing for retrospective application, especially as it relates to the long-term obligations of life insurance companies, will result in inflated surplus at transition, inaccurate subsequent performance measurement (i.e., income) and inconsistency of reporting between in-force and new business as well as between entities. Not allowing for the establishment of an appropriate margin at transition would further unduly penalize companies with long-term obligations and high persistency. Reasonable conventions should also be allowed in the establishment of the margins at transition due to potential historical data limitations. For example, the margin at transition could be established as the present value of future excluded cash flows (e.g., costs that do not very directly to the contract or contract activities, such as general overheads) for participating products.

(b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?

No. An amount equal to the residual margin should not be eliminated at transition for the reasons stated in our response to question 17(a) above.

(c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?

Yes. We believe it is important to align the finalization of the insurance contracts standard with the deliberations and finalization of the financial instruments standard in order to avoid misleading insurer reporting during the transition periods and on a longer term basis.

(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

Substantial effort and cost, including significant required systems modifications, will be required by most insurance entities to adopt and implement the proposed standard. We therefore believe a minimum of three years should be allowed for transition.

Question 18 – Other comments

Do you have any other comments on the proposals in the exposure draft?

While we generally agree with the principles of the building block approach that are included within the proposed standard, we believe the proposed standard is both a significant and fundamental departure from the methods of financial reporting currently in use throughout the world today. As such, we believe sufficient time be devoted to field testing and responding to industry concerns. Without fully contemplating and addressing industry concerns, the final standard will likely result in insurance contract measurements that do not reflect economic substance and provide less than useful information to users of financial statements for the purpose of making economic decisions. The issuance of a high quality and fully vetted insurance contracts standard is of far greater importance than meeting an arbitrary deadline. We understand the pressures the Board is under to meet its June, 2011 goal for final issuance but nonetheless question whether that timeframe sufficiently allows for adequate field testing and appropriate deliberations to understand and address valid industry concerns. We further believe additional time may be needed to fully converge with the FASB which we believe is of critical importance if IFRS is to become truly accepted as a global standard and eliminate the need of many multi-national insurance

companies to prepare "GAAP" financial statements on more than one basis. Only by achieving convergence will the benefits truly exceed the costs (see also our response to question 19 below).

Question 19 – Benefits and costs

Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.

Yes. On balance, we agree with the Board's assessment of the benefits and costs of the proposed standard. More specifically, if the final standard sufficiently addresses the shortfalls noted throughout our response and identified by others in industry, we agree that the proposed standard will provide information about an entity's financial position, financial performance and cash flows that are useful to a wide range of users in making decisions while resulting in enhanced comparability of financial reporting among insurers. These benefits, which also include facilitating the functioning of markets for capital, including credit, and the efficient allocation of resources in the economy will outweigh the costs notwithstanding that they will be disproportionately borne by existing investors. However, we do specifically disagree with the Board's conclusion surrounding the benefits of determining a separate risk and residual margin in its assessment of the benefits and costs. See also our response to question 18 above.

We estimate the costs of implementing the proposed standard to be in the range of USD 15 - 25 million as implementation will include substantial systems development.