

December 15, 2010

Ms. Leslie F. Seidman  
Acting Chairman, Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, Connecticut 06856-5116

Dear Ms. Seidman,

We appreciate the opportunity to comment on the Discussion Paper, *Preliminary Views on Insurance Contracts* (DP) issued in September 2010. The ACE Group of Companies provides a broad range of insurance and reinsurance products to insureds worldwide through operations in more than 50 countries around the world, and has the authority to conduct business in over 140 countries. ACE Limited, the Swiss incorporated holding company of the ACE Group of Companies, is publicly traded on the New York Stock Exchange. Given our global presence and public reporting responsibilities, we are very interested in the development of a single global insurance accounting standard and the potential effect it will have on public reporting. Historically, the majority of our business has been property/casualty. As such, much of our perspective in this discussion is generated from that perspective. However we are equally concerned with the impact of the new standard on life insurers. We are particularly concerned that the use of a risk free rate with liquidity adjustment rather than the market rate assumed in pricing to discount the guarantee included in certain policies will result in losses at the inception of the policy that do not appear to reflect the economics of that policy.

We believe it is preferable to have one global accounting standard for insurance contracts. However, we believe this should only be undertaken if a new global standard is clearly superior to current U.S. GAAP. The accounting model(s) for insurance contracts that is currently used in most of the world, including the U.S., is applied on a consistent basis and generally understood, and it is not viewed as being in need of significant improvements. While this current model(s) for insurance contracts can be improved, in our view the model proposed in the DP does not provide significant improvements over that model. We continue to believe that the current insurance contracts model best reflects the substance of insurance contracts in that premium written is the best measure of the amount of risk assumed. We also believe the proposed model creates a false sense of precision due to the significant increase in the number of additional estimates that will be required. The proposal to add multiple layers of estimates will have the potential to actually mislead users of the financial statements and reduce the comparability among entities.

The model as proposed adds a significant amount of complexity to both the calculation and the reporting of those results. This additional complexity is based on a theoretical view that primarily focuses on life contracts and is not readily applicable to non-life operations. As such it does not provide additional useful information to the user of financial statements. At the same time it eliminates much of the decision useful information that is currently reported. A better approach would be to have a single global standard with two models that are calibrated more specifically to the differences between life and non-life insurance contracts.

We have included our responses to the specific questions requested in the DP as Appendix A.

We would be pleased to discuss our comments with you, the FASB Board members, or the FASB staff at your convenience.

Sincerely

Philip V. Bancroft  
Chief Financial Officer

## **Appendix A**

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

The proposed definitions appear to be appropriate. The refinements to the existing definitions are not likely to impact entities that currently apply insurance accounting but are likely to require entities that previously were not required to apply insurance accounting to do so.

The present definition of insurance risk included in AS944 that is currently applied in practice provides a model that is understood and readily applied in practice in a manner that adequately identifies insurance contracts.

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

We do not feel that the model as proposed provides any improvement over the current U.S. GAAP model, so extending this model to entities that are not insurance entities will not improve the reporting for those entities either. Conceptually, the consistent application for similar contracts across all entities regardless of the type of entity that issued the contract seems more appropriate.

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

The proposed scope exclusions seem appropriate given that there is existing U.S. GAAP guidance that adequately addresses the accounting for the excluded contracts.

- 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?*

Applying the proposed accounting to employer provided insurance would represent a significant challenge because there is not a distinct premium or cash inflow associated with those plans that can be used to establish the building blocks. This inability to create a comparable liability for an employer provided insurance plan under the proposed model highlights some of the deficiencies within that model.

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

Any requirement to unbundle should be very limited. Any decision to unbundle more components of an insurance contract than those currently included in the proposal would not add any benefit.

## 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?*

Using a cash flow estimate that reflects the full range of possible outcomes represents a significant shift from the current best estimate approach while adding little value over that approach. It does not represent a significant improvement over existing U.S. GAAP.

While the proposed approach may faithfully represent the economics of the liability associated with an insurance contract, it limits the usefulness of the information provided to users of the financial statements. This is because the magnitude of the potential losses that relate to low frequency and high severity exposures requires a significant level of judgment that will not produce a more reliable estimate.

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

We do not feel that a margin approach is preferable to the existing approach under U.S. GAAP. The proposed approach increases the number of less reliable estimates that will be required and creates the illusion of precision that does not exist in the insurance balance sheet. The inclusion of an explicit risk adjustment margin in that determination adds significant subjectivity to the financial results reported under such a model.

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?*

The determination of an explicit risk adjustment margin on the basis of the “amount the insurer would rationally pay to be relieved of the risk that the ultimate cash flows exceed those expected” seems inconsistent with a contract fulfillment basis and moves more to a fair value basis. This concept also allows for significant subjectivity in this calculation.

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

The application of this concept of a risk adjustment is highly subjective which will inherently lead to less comparability. The shortcomings of each of the allowed models are discussed, but entities may focus on different aspects that may result in applying differing models. The assumptions and confidence levels chosen in the applications of those models adds to the subjectivity.

*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?*

We feel that the current model that uses a best estimate to record the insurance liability is the most appropriate since it is time tested and readily understood. The combination of all cash inflows and outflows to determine the insurance liability adds complexity without adding value.

*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?*

Due to the inherent short term nature of many contracts, the effort required in applying a discount to the cash inflows and outflows will be inconsequential. The cost/benefit of applying a discount rate to a premium or claim payment that resolves itself in a relatively short time frame is not justified. We agree with the position of the Securities and Exchange Commission on discounting property and casualty reserves only to the extent that the claims pattern and ultimate cost associated with those reserves are fixed and determinable. As such, we are equally concerned about discounting certain long-tail casualty liabilities because of the degree of uncertainty in the timing and amount of cash flows. We feel that discounting reserves will add another judgment to the reserving process without improving the accounting.

Applying a liquidity adjustment added to the risk free rate will introduce diversity between entities since the liquidity adjustment will be highly subjective. The concept of a liquidity adjustment is not well defined and there is no history in how it would be applied. This will also create a potential comparability issue across insurers.

More importantly, due to the significant leverage of reserves on an insurance entity's balance sheet and that relationship to the income statement, the application of a discount rate to those reserves will introduce significant volatility to its operations based on insignificant changes to the interest rate used. We believe this will ultimately result in the inclusion of additional non-GAAP measures to remove this volatility and present operations in a manner that does not distract underwriting results with interest rate volatility so that results are meaningful to investors.

For life contracts, many insurers use an asset portfolio to support the returns necessary for guaranteed rates. Where these are the economics of the asset management strategy, using the portfolio rate appears to be the appropriate treatment. If an insurer applies a risk free rate to the liability that rate will inherently differ and may result in losses at the inception of the contract even though economically the insurer is not in a loss position. This treatment could ultimately result in the elimination of an entire class of insurance contracts which could have significant consequences to the consumer.

*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?*

The uncertainty about how to treat acquisition costs under this proposed model and the resulting need to aggregate the payment of acquisition costs into the cash flows of the contracts speaks to

the complexity of the proposed model. We do not support any model that results in the immediate expense of acquisition costs.

*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?*

The present definition of incremental acquisition costs is too restrictive. It allows for differing treatment of similar costs depending on the distribution model. For instance certain distribution models utilize direct marketing to generate sales instead of a selling agent. The selling agent commission would be included in the cash outflows, but the direct marketing costs would not even though the direct marketing is in essence the sales force. Expanding this definition to allow for the inclusion of acquisition costs related to all types of distribution seems appropriate.

*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 do not feel that a margin approach, either a composite margin or a two-margin approach, is preferable to the existing approach under U.S. GAAP. The proposed approach increases the number of less reliable estimates that will be required and creates the illusion of precision that does not exist in the insurance balance sheet.

*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?*

See response to question 15.

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

See response to question 15.

*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?*

Two distinct models based on the characteristics of the contracts are appropriate because there are significant economic differences to an insurance entity based on these classifications. Applying a model that was designed to predominantly accommodate life contracts to non-life contracts ignores these distinctions. The modified approach as proposed does not appear to go

far enough to recognize the distinctions between the two general types of contracts especially when current U.S. GAAP is time tested and well understood.

*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)?*

We believe that the current recognition, measurement and presentation approach prescribed under U.S. GAAP for short duration contracts is appropriate. This approach eliminates the need to net acquisition costs against the pre-claim liability because it recognizes the distinct nature of these cash flows. Discounting a liability that by definition is short duration does not improve the current standard.

*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?*

The proposed measurement model attempts to address the accounting for an insurance contract in a very theoretical manner. Many of the conclusions reached do appear to define the economic impact of an insurance contract from the perspective of the balance sheet. However, many of the concepts used to implement this theoretical view are very complex and subjective. This additional element of complexity and subjectivity within the financial statement presentation does not add value to the reporting of these financial results.

The existing U.S. GAAP accounting model that we currently apply is clear in its presentation and allows a user of the financial statements to readily understand the relationships between the premiums received to accept risk and the payments made to fulfill the obligations under these same contracts. The model as proposed introduces a risk adjustment, residual margin, and discount rate, all of which require high levels of subjectivity, that ultimately do not appear to provide a better picture of the economic impact of an insurance contract. This will create a false sense of precision which will be misunderstood by users of the financial statements.

The inclusion of a discount on most non-life reserves is not appropriate due to the highly unpredictable payment pattern of most of the claims paid that are associated with those reserves. The inclusion of a discount rate may ultimately make the carrying amount of those reserves less transparent to users of the financial statements because it actually introduces additional subjectivity to the reserving process while creating the appearance of higher precision.

The amount of leverage that would be generated by discounting insurance reserves will add significant volatility that will not be meaningful to the actual results of the insurance entity. This volatility could distract true underwriting results which are important in the evaluation of an insurance entity. This will result in the inclusion of additional non-GAAP measures to help investors identify these underwriting results.

*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)?*

The proposed differentiation between types of contracts based on a strict period of one year or less creates a distinct rule in a principles based standard that limits an insurer's ability to account for similar contracts under a similar methodology. It seems that a better approach would be to create a principle similar to existing U.S. GAAP that defines what a short duration contract is that is not defined absolutely by a specific timeframe. This would allow all contracts that meet this principle to be accounted for similarly even though they may have a contract boundary that exceeds one year.

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

We feel that the existing U.S. GAAP accounting model is clear in its presentation and allows a user of the financial statements to readily understand the relationships between the premiums received to accept risk and the payments made to fulfill the obligations under these same contracts. The model as proposed removes much of this decision-useful information while not providing information that allows for a better understanding of these risks especially for non-life contracts.

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

We feel that the current model as it applies to insurance contracts provides decision-useful information in that it is a time tested methodology that is well understood by users of financial information.

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

Certain costs associated with applying this new model will have significant one-time components as well as ongoing components. For instance, the revisions to the determination of the claim liability from a best estimate approach to a probability weighted approach will require significant one-time revisions to the systems used to calculate this amount. In addition, it will also require more costs each period as this calculation will be required to be updated each reporting period likely requiring additional actuarial staff to support those calculations.

The costs of changing information systems to capture additional data from the bound date rather than the effective date and would be significant while providing little or no benefit to the reader of the financial statements. The impact to the balance sheet would in most cases be inconsequential.

The level of detail that will be required to provide all of the required disclosures will necessitate changes to systems and greatly increase the cost of preparing this information. Again, this introduces the appearance that there is a greater level of precision in a process that is and will always be inherently less precise.

## **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?*

We agree with this exclusion because other policyholders are not specifically in the business of assuming risk and managing the retention of that risk. The close link between the external risk assumed in the insurance contract ceded and the reinsurance contract that transfers that risk necessitates the inclusion of the impact of reinsurance contracts for insurers, so failure to show those relationships would be misleading. By contrast, other policyholders who purchase an insurance contract do not have such a close link between the assumption of an external risk that directly correlates to the contract that is purchased.

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

Yes, we believe that the accounting for insurance and reinsurance should be the same. The reinsurance model that is applied should be consistent with the model applied to the original insurance contract. This includes the application of the pre-claim liability model to any reinsurance of the original insurance contracts that apply this model. Applying a differing accounting model to the reinsurance of a contract will only increase the level of complexity in understanding the net economic impact of that contract and create financial statement mismatches that do not exist in the economics of the contract.

## **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.*

The accounting for insurance contracts that is currently used in most of the world, including the U.S., is applied on a consistent basis and generally understood, and it is not viewed as being in need of significant improvements. The benefits of retaining an accounting model that is similar to this current practice far exceeds any benefits gained by applying this more theoretical approach to the calculation insurance operations. Any change to the current system should improve the reporting of these results not merely make it more complex and subjective and less decision useful to financial statement users. This alone makes the cost of moving to this model significant. The inability of the markets to understand the results reported by insurance companies could damage the valuations of those companies.

The accounting model described in the DP does not align with the manner in which most insurers are managed and, depending on whether a product is treated under the building block approach or the pre-claim liability approach, would remove from the statement of comprehensive income

many of the measures and metrics commonly used today to measure an insurer's performance. This would inherently limit the decision-useful information about performance included in those financial statements.

*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 do not feel that the margin approach described in this DP is an improvement over existing U.S. GAAP. Therefore, we do not feel that the current approach should change.

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

Given the significant difference between the economics of the two types of insurance contracts, it seems that a single model will not allow an accurate presentation of both risks. Based on these differences, it remains unclear why it should be necessary to include all insurance contracts in a single model.

*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?*

The current disclosures required under U.S. GAAP when coupled with the additional disclosures required in the U.S regulatory environment are appropriate, time tested, and easy to follow and should be retained.

The significant amount of disclosures required to understand this proposed model are an indication as to its complexity and the inability to truly understand the results generated from its use.

#### **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. This would not be an improvement over existing U.S. GAAP.

*b. Pursue an approach based on the IASB's Exposure Draft with some changes? Please explain those changes.*

No. This would not be an improvement over existing U.S. GAAP.

*c. Pursue an approach based on the Board's preliminary views in this Discussion Paper?*

No. This would not be an improvement over existing U.S. GAAP.

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

No. This would not be an improvement over existing U.S. GAAP.

*e. Make targeted changes to address specific concerns about current U.S. GAAP (for example, items included in paragraph 7)? Please describe those changes.*

Yes. One item in particular would be the treatment of certain acquisition costs such as direct marketing costs similar to other advertising costs. Another item would be the ability to reassess the assumptions used in a long-duration model as needed based on changes in the facts and circumstances.