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December 15, 2010

Technical Director/director@fasb.org  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

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

Dear Sirs:

Goldman Sachs welcomes the opportunity to comment on the FASB's Discussion Paper, *Preliminary Views on Insurance Contracts* ("the DP"). We support the DP's objectives, which include the improvement of US GAAP for insurance contracts by developing high quality guidance that addresses recognition, measurement, presentation, and disclosure. Specifically, the project is intended to improve, simplify, and achieve convergence of the financial reporting requirements for insurance contracts and to provide investors with decision-useful information. The DP summarizes key aspects of the International Accounting Standards Board's (IASB) recent Exposure Draft, *Insurance Contracts* ("the ED," or "the proposal"), and compares the proposed guidance in the ED to alternative preliminary views of the FASB and current US GAAP. Our comments and concerns are limited to those aspects of the DP and ED that we wish to emphasize.

## **Convergence Versus Retention of Current US GAAP**

In recognition of the different starting points in the current guidance for accounting for insurance contracts under international financial reporting standards and US GAAP, the DP asks whether the US should pursue targeted improvements to existing standards rather than undertake a fundamental and comprehensive reconsideration of insurance accounting. While we believe transition to a new model such as that proposed by the IASB will be disruptive and expensive, in the long run business and the capital markets will be better served with a single, global standard.

Current US GAAP for insurance contracts was developed long ago, and is based, in large part, on the old matching principle which is no longer an objective of the current conceptual framework. In addition, particularly with respect to long-duration property and casualty contracts, the current model often does not reflect the economics of the business. While we highlight some of the concerns we have with the current IASB proposal below, we believe, with some modifications, it is an acceptable model that represents an improvement over current US GAAP.

### **Fair Value Option**

We believe the fair value option should be preserved for insurance contracts. We believe fair value should always be an option for financial instruments, and that new accounting guidance should not require companies to move away from fair value measurements.

The proposal scopes in financial guarantee contracts, which some companies currently account for at fair value. In addition, the initial model proposed by the IASB for insurance contracts was an exit value approach. We understand that many constituents objected to that approach, as there is no market for exiting these liabilities, and many believed that consideration of the insurer's credit in the measurement of insurance liabilities did not make sense. We note, however, that the current fulfillment value approach moves the proposal farther away from fair value than mere elimination of the adjustment for insurer credit would have, and as such, we believe fair value should continue to be an option.

### **Unbundling**

#### Unbundling Would Be Arbitrary

Unbundling as proposed in the DP and the ED would be arbitrary and even unbundling of contracts with an explicit account balance draws artificial distinctions between products. Account balance product elements are priced with internal subsidies, which would lead to misleading presentation if separated. Consider a universal life product where expense, profit margin, and enhanced crediting rate are all born by the cost of insurance charge. The account balance on a stand-alone basis is a "financial contract" that offers superior

returns via an enhanced crediting rate that is granted in compensation for the purchase of life insurance. The financial statement reader would see severe spread compression (credited interest in excess of earned) if the investment contract were measured under a different basis and separated from the rest of the contract made with the consumer. Pricing makes all elements of insurance contracts dependent and therefore closely related.

Contracts that do not have an explicit account balance are not necessarily economically dissimilar to those that do. Creating an exaggerated case illustrates the underlying truth of the situation. An actuary can easily develop a life contingent immediate annuity with an account balance that is transparent to the consumer – with identical cash flows to immediate annuities available in the market today. Clearly, unbundling this new product would not enhance comparability within the financial statements. Presence of an account balance is form over substance.

Contracts with neither an explicit account balance nor a crediting rate may pass on the performance of underlying investments even more closely than those that do. Consider participating whole life insurance, especially blocks maintained by stock companies. All of the performance – investment and other - is passed on (by law) to the policyholders. The policyholders are essentially owners (or shareholders) of the investment/insurance portfolio. To produce comparability, one would need to unbundle participating policyholders' equity stake from the insurance protection provided, which cannot be done because the two are intertwined.

#### Unbundling Introduces Complexity Without Commensurate Transparency

While unbundling introduces complexity in accounting, it will not produce greater transparency for financial statement users. There is currently insufficient guidance to ensure that all preparers will produce the same measurement under the same circumstances. For example, it is not clear an insurer would allocate acquisition costs between the two or more split parts, or which portion of the contract would be assigned back end loads, and results could vary based on how these amounts are allocated (e.g., whether a Day 1 loss is recognized on the insurance component of the contract).

#### The Unbundling Guidance in the ED is Contradictory

The unbundling guidance in the ED related to account balances is contradictory. The ED states that unbundling is required for account balances credited with an explicit return based on the investment performance of either a specified, notional, or general account pool of assets. The crediting rate must pass on to the individual policyholder all investment performance, net of contract fees and assessments (paragraph 8(a)). The direct link between crediting rate and investment returns on a pool of assets suggests that products where the insurer has discretion in setting the crediting rate, which may be influenced by but not directly tied to general account investment returns, would be scoped out of the unbundling requirement. For example, under this interpretation, insurers would not unbundle the investment component of most Universal Life and all

fixed annuity contracts, as these products have crediting rates that are not directly tied to a pool of assets – whether held by the insurer or notional.

The proposal goes on to say, however, that cross subsidy effects included in the crediting rate should be allocated to the insurance component or another component, but are not part of the investment component (paragraph 9). How can an account balance with a crediting rate directly tied to the return on a pool of assets also have a crediting rate that is subsidized by other contract fees?

We recommend that the Boards remove unbundling as currently described from the proposed accounting standard. Unbundling is practical and appropriate only in cases where insurance risk and cash flows are not affected by and are completely independent of the separated financial element.

### **Reinsurance**

The IASB’s decision that reinsurers should record Day 1 “losses” on reinsurance contracts will lead to anomalous results; we envision potential non-economic losses under the proposal on assumed “portfolio transfers” of existing liabilities because the initial measurement attribute for insurance liabilities is not fair value. In these transactions, the reinsurer may assume, for example, a block of existing life contracts and receive from the ceding company assets in an amount expected to be sufficient to fund those liabilities and provide a profit to the reinsurer. Current practice in accounting for these transfers in some jurisdictions is to account for any shortfall in the value of the assets received compared to the liabilities assumed as deferred acquisition costs, under the theory that the difference does not reflect a Day 1 loss as the reinsurer would not willingly enter into a loss-making contract. We believe that the recognition of a Day 1 loss in these circumstances does not faithfully represent the economics of these transactions.

Because the Board has prescribed different measurement attributes for the assets (fair value) and the liabilities (fulfillment basis) transferred in an assumed portfolio transfer, we recommend that the model allow insurers to defer of any “loss” resulting from different measurement attributes to better represent the economics of these transactions.

### **Presentation in the Statement of Financial Position**

We agree with the proposal that the rights and obligations of an insurance contract or portfolio of contracts should be shown on the balance sheet as a single line item within insurance contract assets or insurance contract liabilities (paragraph 69), as the unit of account for accounting purposes should be at the contract level. This single line presentation also aligns insurance contract accounting treatment with that of other contracts with customers under the Board’s proposed guidance on revenue recognition.

## **Prescribed Calibration Techniques**

As a matter of principle, we do not believe that the ED should proscribe the permitted techniques for estimating risk adjustments (paragraph B73). We believe that accounting standards should articulate principles and objectives and permit companies to exercise judgment in applying standards and fulfilling these goals.

## **Transition**

The proposal's transition guidance would effectively eliminate any future profits and losses on contracts in existence upon adoption, except for the release of the residual margin and the effects of changes in estimates. For a life insurer, this depression in future profits could last for decades, distorting the insurer's results and putting insurers at a comparative disadvantage to other industries.

The Boards should research alternative approaches – for example, an alternative allowing insurers to record a residual margin at transition that would calibrate recorded liabilities under the proposal to current prices that the insurer would charge for contracts with similar conditions and remaining terms.

Thank you for the opportunity to provide our views. If you have any questions or comments regarding this letter, please do not hesitate to contact Susan McGrath at 212-902-1862.

Sincerely,

A handwritten signature in black ink that reads "Matthew L. Schroeder". The signature is written in a cursive, slightly slanted style.

Matthew L. Schroeder