



December 15, 2010

Technical Director  
Financial Accounting Standards Board  
401 Merrit 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Subject: File Reference No. 1910-100

Dear Sir:

Endurance Specialty Holdings Ltd. ("Endurance") appreciates the opportunity to provide comments to the Financial Accounting Standards Board ("FASB") on the Discussion Paper ("DP") *Preliminary Views on Insurance Contracts*.

Endurance is a global specialty provider of property and casualty insurance and reinsurance. Through its operating subsidiaries, Endurance writes property, casualty, healthcare liability, agriculture and professional lines of insurance and property, catastrophe, casualty, aerospace and marine, and surety and other specialty lines of reinsurance. We prepare our consolidated financial statements in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). Our gross premiums written were \$2.0 billion for the year ended December 31, 2009 and our shareholders' equity was \$2.8 billion at December 31, 2009.

### **A global accounting standard for insurance contracts**

Endurance supports the development of a single, global, high quality financial reporting and accounting standard for insurance contracts. A global insurance contracts standard would enhance comparability of insurance companies across countries and reporting standards for the investors and other primary users of financial statement information. The views expressed in this comment letter were also expressed in a similar comment letter which was submitted to the International Accounting Standard Board ("IASB") in response to the Insurance Contracts Exposure Draft ("ED") released July 30, 2010. We have attached a copy of our letter to the IASB which expresses our views on specific proposals in the ED. See Exhibit A.

### **Current U.S. GAAP model for insurance contracts**

We believe that the current U.S. GAAP model for insurance and reinsurance contracts is a complete, comprehensive set of standards which have successfully produced high quality financial reporting for many years. This model has been tried and tested over a number of years and provides users with relevant, reliable, transparent, and decision-useful information which is comparable year over year and among



insurance and reinsurance companies. This model is familiar to users and does not have serious issues which need to be corrected.

We believe the proposed model described in the DP will result in reduced comparability, increased volatility and less decision useful information to investors primarily due to the following:

- The subjective nature of the risk margin makes it prone to manipulation and error, as the risk margin would be open to interpretation and would be difficult to objectively verify or audit in a cost effective manner, which reduces the reliability and the comparability between companies and ultimately the usefulness of the information to investors. In addition, the requirement to remeasure the risk margin each quarter would increase the volatility in the financial statements.
- The change in boundary definition also reduces comparability as it is very possible that the recognition of insurance contracts by companies participating in syndicated placements will be different when the underlying contract or exposure period is the same, resulting in confusion among investors.
- The process to calculate the illiquidity premium (required as part of discounting the cash flows) is unclear, which could result in companies using varied methods.
- The proposed model eliminates current key industry metrics (such as gross written premium, net earned premium, losses and loss adjustment expenses, and various ratios), which have long been relied on by investors.

The judgments required throughout the proposed standard significantly increase subjectivity in estimation processes and correspondingly reduce the ability of auditors and other third parties to objectively verify financial statements. We believe that any specific concerns with the current model should be addressed using a targeted approach rather than introducing an entirely new, untested model as proposed, which reduces comparability, increases earnings volatility and does not provide users with the information they require to make decisions regarding insurance companies.

#### **Differentiation of measurement approach for short-duration and long-duration contracts**

Endurance supports the proposed approach of differentiating between short-duration and long-duration insurance contracts. We support the modified approach; however, we would like to see this extended to produce a distinctly separate measurement approach, one which is specifically for short-duration contracts. Short-duration contracts, particularly property and casualty ("P&C") contracts, are inherently different from long-duration insurance contracts, in that long-duration contracts have more variables which are more easily estimable (e.g. for a life insurance contract, the loss amount and fact that a loss will occur are known, and it is mainly the timing of the loss that is uncertain). In contrast, losses on P&C contracts are harder to predict, as there may or may not be a loss at all, and the loss amount and payment timing is unknown until an insured event occurs. Therefore, the proposed "building block" approach discussed in the DP is more relevant for long-duration contracts, and short-duration contracts should be measured using a distinctly separate approach. We believe the measurement approach for short-duration contracts should be based on an unearned premium model similar to the modified approach and consistent with current U.S. GAAP accounting for such contracts.



We do not believe that the building block approach appropriately reflects the economics of short-duration contracts, specifically specialty P&C products which are not homogeneous and predictable. For example, under the building block approach, a portion of expected catastrophe losses would be recorded upon recognition of a catastrophe reinsurance contract as a result of the probability-weighted cash flow scenarios used to estimate reserves. The occurrence of catastrophe events is unpredictable and may not occur in any given year. However, these contracts are usually written for the term of one year and any catastrophic events which occur are known by the end of the contract term. We struggle to see how booking hypothetical losses provides decision useful information for our investors or users of our financial statements. We believe catastrophe related losses should only be recorded as incurred. As such, we are in favor of a definition for short-duration contracts that would encompass these types of policies.

The DP discussed a "bright line" definition of a short-duration contract, which includes all contracts with coverage of approximately one year or less which do not include embedded options or other derivatives. This definition is narrow and a departure from the principles based approach of the overall proposed standard, and therefore is open to manipulation. U.S. GAAP already includes definitions of short-duration and long-duration insurance contracts. The definition of a short-duration contract as stated in Accounting Standards Codification ("ASC") 944 is as follows:

The factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are as follows for a short-duration contract:

- a. The contract provides insurance protection for a fixed period of short duration.
- b. The contract enables the insurer to cancel the contract or to adjust the provisions of the contract at the end of any contract period, such as adjusting the amount of premiums charged or coverage provided.<sup>1</sup>

The definition of a long-duration contract as stated in ASC 944 is as follows:

The factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are as follows for a long-duration contract:

- a. The contract generally is not subject to unilateral changes in its provisions, such as a noncancelable or guaranteed renewable contract.
- b. The contract requires the performance of various functions and services (including insurance protection) for an extended period.<sup>2</sup>

We believe that these definitions are reasonable, principles-based and appropriately separate contracts with different economic characteristics. These definitions have worked well for U.S. GAAP insurers; therefore, we would propose that these definitions continue to be used to determine which contracts are subject to the modified approach (short-duration) and which are subject to the building blocks approach (long-duration).

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<sup>1</sup> ASC 944-20-15-7

<sup>2</sup> ASC 944-20-15-10



The onerous contract test as described in the DP would require insurers to apply the full building block model to determine if a short-duration contract is onerous (albeit at a more aggregated level), which, in our opinion, defeats the purpose of permitting a separate measurement method for short-duration contracts. The cost of maintaining the required information to perform the onerous contract test is greater than the benefit obtained from performing the test (which is basically a premium deficiency calculation). Endurance proposes that the onerous contract test be modified to compare the pre-claims obligation to reserves as calculated under current U.S. GAAP for insurance companies.

### **Probability-weighted Cash Flows**

The current definition of "probability-weighted estimate of net cash flows" in the DP would require losses associated with infrequent but severe events to be estimated before the event giving rise to the loss is known. Losses on P&C contracts are usually significant, the ultimate costs for which are not known until the loss event is reported and settled. In many cases, a loss may not even be reported during the coverage period. Even when an event does occur, the probability-weighted cash flow estimate could be significantly lower than the actual loss, and would result in a significant adjustment when the actual cost of the event is known. This probability-weighted estimate is also a new concept for the industry and there are currently no generally accepted P&C actuarial methods that could be used to calculate the probability-weighted cash flows. This would result in diversity in practice among companies. This method is also not tested or trusted in the marketplace and therefore could be met with resistance from users of the financial statements. Companies also do not have the systems in place required to calculate the cash flows. These systems would be costly to implement and require significant time and investment. The current U.S. GAAP method of selecting a best estimate in a range of possible reserve estimates is a tested and trusted method which has been used successfully for decades, and Endurance believes that this is the best measure of the claims liability.

### **Timeline**

We are concerned about the timeline for this project, as the IASB would like to produce a final insurance contracts standard by mid-2011 and there are a number of areas where the views of the FASB and IASB differ. As the proposed changes are a significant departure from current GAAP, we are concerned that the FASB and IASB may not be able to work through the areas where there is a difference of opinion between the boards and produce a high quality accounting standard which addresses concerns from all parties by mid-2011. Any rush to converge accounting standards to meet an arbitrary timeline would very likely result in unintended negative consequences, as there would not be enough time to perform adequate analysis on the various impacts the new standard would have. For example, companies would need to perform an analysis of costs to comply with the standard and address the impact of changes required to current systems, existing accounting and auditing professionals would need to be adequately trained on the new standards, and companies and auditors would need to ensure the new standards can be audited at a reasonable cost. We believe that the boards should focus on developing a consistent, high quality standard as opposed to producing a final standard within the stated deadline.



Thank you for consideration of our comments.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Michael J. McGuire".

Michael J. McGuire  
Chief Financial Officer  
Endurance Specialty Holdings Ltd.



November 30, 2010

Sir David Tweedie  
Chairman, International Accounting Standards Board  
30 Cannon Street  
London, EC4M6XH  
United Kingdom

Re: IASB Insurance Contracts Exposure Draft

Dear Sir David:

Endurance Specialty Holdings Ltd. ("Endurance") appreciates the opportunity to provide comments to the International Accounting Standards Board ("IASB") on the Insurance Contracts Exposure Draft ("ED").

### **A global accounting standard for insurance contracts**

Endurance supports the development of a single, global, high quality financial reporting and accounting standard for insurance contracts. A global insurance contracts standard would enhance comparability of insurance companies across countries and reporting standards for the investors and other primary users of financial statement information. The views expressed in this comment letter are also being expressed in a similar comment letter which will be submitted to the Financial Accounting Standard Board ("FASB") in response to the Preliminary Views on Insurance Contracts Discussion Paper ("DP") released in September 2010.

### **Differentiation of measurement approach for short-duration and long-duration contracts**

Endurance supports the proposed approach of differentiating between short-duration and long-duration insurance contracts. We support the modified approach; however, we would like to see this extended to produce a distinctly separate measurement approach, one which is specifically for short-duration contracts. Short-duration contracts, particularly property and casualty ("P&C") contracts, are inherently different from long-duration insurance contracts, in that long-duration contracts have more variables which are more easily estimable (e.g. for a life insurance contract, the loss amount and fact that a loss will occur are known, and it is mainly the timing of the loss that is uncertain). In contrast, losses on P&C contracts are harder to predict, as there may or may not be a loss at all, and the loss amount and payment timing is unknown until an insured event occurs. Therefore, the proposed "building block" approach discussed in the ED is more relevant for long-duration contracts, and short-duration contracts should be measured using a distinctly separate approach. We believe the measurement approach for short-duration contracts should be based on an unearned premium model similar to the modified approach and consistent with current U.S. GAAP accounting for such contracts.

We do not believe that the building block approach appropriately reflects the economics of short-duration contracts, specifically specialty P&C products which are not homogeneous and predictable. For example,

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under the building block approach, a portion of expected catastrophe losses would be recorded upon recognition of a catastrophe reinsurance contract as a result of the probability weighted cash flow scenarios used to estimate reserves. The occurrence of catastrophe events is unpredictable and may not occur in any given year. However, these contracts are usually written for the term of one year and any catastrophic events which occur are known by the end of the contract term. We struggle to see how booking hypothetical losses provides decision useful information for our investors or users of our financial statements. We believe catastrophe related losses should only be recorded as incurred. As such, we are in favor of a definition for short-duration contracts that would encompass these types of policies.

The ED included a "bright line" definition of a short-duration contract, which includes all contracts with coverage of approximately one year or less which do not include embedded options or other derivatives. This definition is narrow and a departure from the principles based approach of the overall ED, and therefore is open to manipulation. U.S. GAAP already includes definitions of short-duration and long-duration insurance contracts. The definition of a short-duration contract as stated in Accounting Standards Codification ("ASC") 944 is as follows:

The factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are as follows for a short-duration contract:

- a. The contract provides insurance protection for a fixed period of short duration.
- b. The contract enables the insurer to cancel the contract or to adjust the provisions of the contract at the end of any contract period, such as adjusting the amount of premiums charged or coverage provided.<sup>1</sup>

The definition of a long-duration contract as stated in ASC 944 is as follows:

The factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are as follows for a long-duration contract:

- a. The contract generally is not subject to unilateral changes in its provisions, such as a noncancelable or guaranteed renewable contract.
- b. The contract requires the performance of various functions and services (including insurance protection) for an extended period.<sup>2</sup>

We believe that these definitions are reasonable, principles-based and appropriately separate contracts with different economic characteristics. These definitions have worked well for U.S. GAAP insurers; therefore, we would propose that these definitions be used to determine which contracts are subject to the modified approach (short-duration) and which are subject to the building blocks approach (long-duration).

The onerous contract test as described in the ED would require insurers to apply the full building block model to determine if a short-duration contract is onerous (albeit at a more aggregated level), which, in our opinion, defeats the purpose of permitting a separate measurement method for short-duration contracts.

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<sup>1</sup> ASC 944-20-15-7

<sup>2</sup> ASC 944-20-15-10



The cost of maintaining the required information to perform the onerous contract test is greater than the benefit obtained from performing the test (which is basically a premium deficiency calculation). Endurance proposes that the onerous contract test be modified to compare the pre-claims obligation to reserves as calculated under current U.S. GAAP for insurance companies.

The proposed "claims liability" includes discounted probability weighted cash flows and a risk adjustment. It is unclear from the ED the extent of probability weighed cash flow scenarios that an insurer should run. Losses on P&C contracts are not known until the loss event occurs, and even when an event occurs the final settlement amount is a range of estimates on which it would be impractical and extremely subjective to assign a probability weighting. This is a new concept for the industry and there are currently no generally accepted P&C actuarial methods that could be used to calculate the probability weighted cash flows. This would result in diversity in practice among companies. This method is also not tested or trusted in the marketplace and therefore could be met with resistance from users of the financial statements. Companies also do not have the systems in place required to calculate the cash flows. These systems would be costly to implement and require significant time and investment. The current U.S. GAAP method of selecting a best estimate in a range of possible reserve estimates is a tested and trusted method which has been used successfully for decades, and Endurance believes that this is the best measure of the claims liability.

### Discounting

Endurance does not believe that discounting pre-claim liabilities for short duration contracts is appropriate. We believe that users of the financial statements of P&C companies are more interested in the nominal value of reserves than the discounted value of reserves, particularly for short-duration contracts. Changes in the reported value of reserves from interest rate changes would be viewed as confusing to investors, and would likely be removed when users are reviewing P&C insurers' financial statements, particularly as there is no broad liquid market to settle these liabilities at other than the nominal value.

We support the recognition of the economic value of insurance liabilities in the global insurance accounting model. Because of the nature of non-life insurance contracts, the pre-claims liability represented by unearned premium reserves generally would not need to be re-discounted, as discounting is a fundamental component of its original valuation. The post-claims liability, representing the economic value of future cash flows necessary to settle the obligation in the normal course of business, should reflect the time value of money.

We believe that this post-claims liability should reflect management's best estimate of future cash flows discounted utilizing duration matched risk free rates. Management's estimate should include its own entity specific assumptions for non-financial assumptions such as underwriting characteristics, claims settlement expenses, etc. Other financial or market based assumptions such as inflation and interest rates, should be applied as consistently as practicable by all reporting entities using relevant current market information. The measurement of the post-claims liability should be performed on a portfolio basis consistent with the manner in which the business is managed in order to provide the most relevant and decision useful information to users of the financial statements. No illiquidity premium should be added as it seems counter intuitive to further reduce pre- and post- claim liabilities due to the fact that the liabilities can't be discharged or sold. This fact does not change the underlying amount that must be paid to satisfy the liability, which we believe is the focus of most investors and users of the financial statements. In addition, there is no clear guidance on



the calculation of illiquidity premiums and thus the likely result would be reduced comparability between insurers' financial statements.

### **Two margin vs. composite margin approach**

Endurance supports a single composite margin approach to depict the risk and uncertainty inherent in long-duration insurance contracts. While there are benefits of a two margin approach, these benefits are not sufficient to outweigh the cost of implementation and ongoing costs to prepare the two margins. Calculating and disclosing a separate risk adjustment is a subjective exercise. The level of subjectivity and judgment inherent in the calculation and selection of the risk methodology decreases its usefulness to financial statement users by reducing its reliability and comparability with other companies and does not add decision making value. The subjective nature of the dual margin approach also makes it prone to manipulation and error, as the risk margin would be open to interpretation and would be difficult to objectively verify or audit in a cost effective manner. Separate disclosure of the risk margin could lead to unintended, misleading and harmful interpretations by some financial statement users, such as an assumption that the adequacy of claim liabilities is directly correlated to the size of the risk margin, or that the margin is representative of future profits.

A composite margin is also simpler to calculate and more transparent to users of the financial statements than the dual margin approach. The dual margin approach would require separate calculation and disclosure of the risk margin, which would require additional systems and processes to gather the required information and calculate the risk margin. The risk margin and related inputs would also need to be reviewed and audited. In addition, companies would be required to disclose additional information regarding the confidence level to which the risk adjustment corresponds. The risk margin is also required to be remeasured, therefore requiring a full calculation each reporting period. However, the composite margin is calculated as the difference between the present value of expected cash inflows and outflows and is not remeasured, therefore no additional processes are required. As a result, the composite margin will be easier and less costly to implement initially and to use going forward.

### **Boundary definition**

The ED indicates that an insurer should recognize an insurance contract liability or asset when the insurer becomes a party to the contract. This definition represents a change from the current practice of recognizing insurance contract liabilities or assets over the risk period. We believe that this is a significant change that provides little benefit. The recognition of insurance contract liabilities or assets over the risk period provides, in our opinion, the most objective and comparable basis for recognition. In the P&C industry, contracts are typically not bound significantly in advance of the start of the risk period; however, substantial amounts of premiums are generally recorded on January 1st of each year. Under the ED's definition of contract boundaries, significant amounts of premiums could be shifted from one year to another simply due to binding prior to December 31st with little or no impact on the earnings of a company (recorded as unearned). In addition, this change in definition would likely require reprogramming of underwriting data systems at substantial costs. In addition, comparability would be significantly reduced as it is very possible that the recognition of insurance contracts by companies participating in syndicated placements will be different when the underlying contract or exposure period is the same, resulting in lack of comparability and confusion among investors.



We believe that the desired effect of seeing potential liability exposure for contracts signed prior to the start of the risk period and the recording of the premiums in the financial statements can be adequately addressed through additional footnote disclosure requirements. We do not feel that a wholesale change in the definition of contract boundary and the ultimately change in recording as a result are required.

### **Usefulness to users**

Endurance recommends that the IASB reach out to the users of insurance company financial statements to obtain their views on what they require from the financial statements and if they find the proposed measurement, presentation and disclosure standards useful for their purposes. The proposed guidance will only result in more useful financial statements if the users believe that they provide relevant information for their decision making. This will be achieved by reducing inconsistencies between entities and across different jurisdictions and capital markets. Users will also require clear and transparent disclosures to assess the basis on which the information was prepared. If the proposed guidance does not produce financial statements which meet the needs of the various user groups, non-GAAP measures will need to be prepared for these users to meet their needs and the financial statements prepared using IFRS will be of limited use. As we discussed above, Endurance supports the development of a single, global standard which can be used as long as the standard increases comparability, reliability and the amount of decision useful information provided to investors or other financial statement users.

### **Insurance industry metrics**

Currently in the insurance industry, there are certain key metrics used by management and other financial statement users (including analysts, regulators and customers) to evaluate insurance entities by comparing them to benchmarks and against each other. These key metrics, mainly gross written premium, net earned premium, losses and loss adjustment expenses, and the net loss ratio, acquisition expense ratio and general and administrative expense ratio, should be retained in the revised guidance to avoid the development of non-GAAP measures for the various users, as discussed above.

### **Presentation and Disclosure**

Endurance supports the recognition of premium as revenue over the contract term in proportion to the amount of insurance protection provided. We believe that losses should be recorded on a discounted basis (excluding short-duration contracts), as incurred based on management's best estimate of the post-claims liability. We believe that changes in the unearned premium reserve, post-claims liability estimate and change in discount should be reflected on the face of the income statement. Changes in assumptions used should be immediately reflected in income. The effects of changes in non-financial or entity specific assumptions and changes in financial assumptions over which the entity has little control should be separately and adequately disclosed so users of the financial statements can make their own assumptions.

### **Cost versus benefit**

We are concerned about the time and cost required to implement the proposed changes to accounting for insurance contracts. We believe that the current U.S. GAAP model is a complete, comprehensive set of



standards which have successfully produced high quality financial reporting for many years. The proposed changes are extensive and will require significant time, effort and one-off and recurring costs to comply with. Changes would be required in financial reporting processes, including significant changes to Sarbanes-Oxley controls and processes. New systems would be required to gather, co-ordinate and store additional information and to calculate the required amounts. Additional training would be required for the board of directors, executives, and the finance, actuarial, and information technology functions and possibly external users (analysts, ratings agencies, regulators and customers). However, the most significant cost would likely be specialized, experienced personnel. Additional experienced, professional personnel would be required to understand, implement and oversee the change from the old standards to the new standards in both the finance function and actuarial function. Currently there is a lack of available actuarial resources globally, in the insurance industry and in accounting firms. This would make it difficult to obtain the resources required to account for insurance contracts under the proposed standard as well as audit the resulting financial statements. These new proposals would also increase the subjectivity and result in less consistency and comparability which would make the application and audit of the financial statements significantly more time consuming and expensive for both preparers and auditors.

We believe that the additional costs related to implement the proposed changes to accounting for insurance contracts outweigh the benefits of the proposed guidance. We believe that the current accounting for insurance contracts can be improved with targeted changes to address specific concerns regarding current U.S. GAAP.

### Transition

Endurance supports a prospective approach for all changes as a result of the proposed standard. Retroactive application would likely be costly and impractical for many insurance companies, as some of the required information would no longer be available.

We are concerned about the timeline for this project, as the IASB would like to produce a final standard by mid-2011. We believe that significant system changes will be required, which will take time to implement in order to gather the necessary data. As the proposed standard is a significant departure from current GAAP, we are concerned that the IASB may not be able to produce a high quality accounting standard which addresses concerns from all parties. We believe that the board should focus on developing a high quality standard as opposed to producing a final standard within the stated deadline.

Thank you for consideration of our comments.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Michael J. McGuire".

Michael J. McGuire  
Chief Financial Officer  
Endurance Specialty Holdings Ltd.