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

Ms. Leslie F. Seidman, Chairman
Financial Accounting Standards Board
401 Merrit 7
Norwalk, CT 06856-5116

Re: Insurance Contracts Exposure Draft (ED) – Reinsurance

Dear Sir David Tweedie and Ms. Leslie Seidman:

The American Council of Life Insurers (ACLI)¹ welcomes the opportunity to provide additional comments on the Insurance Contracts Exposure Draft (ED). The purpose of this letter is to expand on our previous comment letters to address the subject of reinsurance. Our response contains a set of examples prepared for the purpose of understanding the financial impact of reinsurance agreements. Not only have these examples served as an educational tool for us, we believe they could serve to educate the Boards.

Summary

Our assessment of the proposed ED guidance for reinsurance is that the guidance contained in paragraphs 43-46 is incomplete and does not provide sufficient information to properly measure and report reinsurance transactions. Not only is the guidance inadequate, we disagree with some of the essential elements of the guidance, which are addressed in this response. Specifically, with regard to Question 16 of the ED and related paragraphs 43-46, our comments focus on the following critical issues of concern:

1. Question 16a, expected loss model and provision for credit risk-We believe it is inappropriate and inconsistent to take into account the credit risk of the reinsurer, who by definition, is an insurance company, when the proposed guidance excludes non-performance risk of the insurer in the measurement of the insurance contract obligations. In any event, default risk should reflect the economics of the transaction, which we believe to be near zero, i.e., immaterial.
2. Question 16b, recognition of a gain for certain reinsurance contracts-The proposed guidance would recognize a gain at initial recognition for the cedant insurer when the expected present value of cash inflows plus risk adjustment exceeds the present value of cash outflows. Consistent with the guidance for the measurement of insurance contracts, conceptually, there should be no gain recognized at inception for direct or reinsured business. While we do not have a specific recommendation at this time, alternative methods are provided for the Boards consideration, and we look forward to an opportunity to discuss these options with the Boards.

Question 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?

¹ The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S life insurance and annuity industry.

The ACLI strongly encourages FASB and IASB to reconsider its emerging thought pattern on credit risk with respect to reinsurance recoveries. We believe it is inappropriate to incorporate a reduction for the expected present value of defaults in the measurement of a reinsurance asset, unless the reinsurance is currently in default.

Incorporating default risk in the measurement of reinsurance assets is inconsistent with the valuation of direct liabilities:

The measurement of reinsurance assets should, first and foremost, seek to achieve consistency with the measurement of insurance liabilities. The ED disallows the effects of credit risk in the discount rate used to measure insurance liabilities. Therefore it would seem inconsistent to mandate an expected loss model, which effectively incorporates the credit risk of reinsurance assets.

IASB recognized the difference between the valuation of insurance and other financial instruments when it decided against reflecting insurance entities' own credit risk of non-performance in the measurement model. This same theory is applicable to the valuation of reinsurance.

Valuation of reinsurer credit risk is complex; reinsurer credit risk is neither reasonably certain nor reasonably estimable; and the expected value is close to zero in any event:

The effort to include a default charge on reinsurance cash flows is complex and difficult, and the result would usually be close to zero and immaterial in any event.

If a credit risk provision is to be included, it should entail an economic assessment of the pattern of potential reinsurer cash flow defaults on the amounts it is obligated to pay under the reinsurance agreement rather than a proxy like the credit rating of the reinsurer. We found the proposed guidance in paragraph 44 unclear and believe that it may lead to unintended consequences that the Boards may not have considered when making the tentative decision to include a default adjustment in the measurement. For example, one interpretation of the paragraph is that the default adjustment should be applied to the estimate of the expected benefit payments from the reinsurer. The following example illustrates this view. Assuming a 100% coinsurance contract that has the same fact pattern as the direct contract except that a default rate of 1.0% is calibrated based upon the reinsurer's rating of AA-/Aa3, at inception the measurement would be:

	<u>Direct Policy</u>	<u>100% Coinsurance</u>
Measurement of Liability:		
1. PV of future benefits	1,400.0	(1,386.0)
2. PV of future expenses	1,000.0	(1,000.0)
3. PV of future premiums	<u>(2,500.0)</u>	<u>2,500.0</u>
4. PV of fulfillment cash flows	(100.0)	114.0
5. Margin-Gain/(loss)	<u>100.0</u>	<u>(114.0)</u>
6. Gain/(loss) at inception	<u>0.0</u>	<u>0.0</u>

The result of including a credit default in the measurement of the reinsurance contract is that the margin absorbs the entire effect of the 1.0% credit risk applied to the measurement of the reinsurance present value of future benefits. The amortization of the reinsurance margin may or may not unwind consistent with the release of the default risk, which would not serve as a faithful representation of the business.

Another view is that since reinsurance contracts are settled net, the default adjustment should apply only to net cash flows due from the reinsurer. This would occur only in accounting periods when the benefits and allowances due the cedant exceed the reinsurance premiums due the reinsurer. In the common scenario when

measurement of a reinsurance contract results in a PV loss to the cedant, if we assume that reinsurance cash flows are uniform over the life of the contract, there would be no default charge since all net cash flows will be payable to the reinsurer. Because of the nature of net settlements, a simplistic default charge will not capture the complexity and variability of the default exposure.

Furthermore, insolvent insurers are managed and ultimately liquidated under unique receivership laws. Receivers guide the insolvent entity to pay its claims over time and in many cases arrange for another reinsurer to assume the block of business, whereas default factors based on credit ratings simply look to default in a more binary fashion. We believe that any credit risk analysis based on credit ratings distorts the financial picture for reinsurance and would overstate potential default haircuts especially when reinsurers are regulated insurance entities and should be accorded the same treatment as the cedant.

Any collectibility analysis should also consider the availability of collateral as an offset to credit risk on the reinsurance recoverable. For example, the reinsurance industry has developed a construct known as “funds withheld” to manage certain credit risk concerns. In “funds withheld” reinsurance, the cedant retains a portion of assets representing future payables to the reinsurer. The cedant records a liability to the reinsurer in the amount of the funds withheld, but the cedant retains legal possession of the assets to the extent the cedant needs to use the assets to satisfy reinsurance payables from the reinsurer to the cedant. There is a similar construct known as “modco”, which is short for modified-coinsurance that achieves a very similar credit risk protection for the cedant. Further, there are other constructs that provide reinsurance collateral for the cedant including letters of credit and reinsurance trusts. The financial reporting of reinsurance assets should reflect these economic realities.

Finally, analogies tend to be drawn between bond defaults and potential reinsurance defaults, but the following differences should be considered. Bond defaults are determined through analysis of a large number of diverse issuers in each rating class. Mathematically, one can observe a percentage of issuers, greater than zero, which become impaired and then estimate with reasonable accuracy a projected amount of write-downs for a given period. With respect to reinsurance, however, an insurer is likely to engage in reinsurance transactions with only a few reinsurers. Consequently, the mathematics, “law of large numbers”, used to determine a provision for bond defaults may not be an appropriate measure to reasonably estimate reinsurance defaults.

Provision for credit risk in reinsurance assets leads to confusing financial statements and is not helpful to readers of the statements:

We believe that including a default charge greater than zero on reinsurance cash flows will not result in a faithful representation of the reinsurance value. Reinsurance failures occur in unlikely adverse scenarios, which is what capital is intended to cover. Regulatory schemes in most jurisdictions impose capital requirements for this purpose. Any additional requirements to reduce income for reinsurance credit risk would essentially double count the provision for reinsurance default.

Furthermore, the cedant should neither benefit from an improving reinsurer nor be hurt by a deteriorating (but still performing) reinsurer until such time as a default occurs. Finally, it will be confusing to users of financial statements for reinsurance transactions to be reported differently from one company to another based on their individual assessment of a reinsurer’s credit risk.

Therefore, our recommendation is that the credit risk of the reinsurer should not be taken into account since the reinsurer, by definition, is an insurance company. The guidance for reinsurance should align with the guidance for measurement of direct insurance contract obligations, where non-performance by the insurer is not taken into account. Furthermore, the added cost to measure the default risk, which we believe will be almost zero, does not provide sufficient benefit to the users to justify the cost.

Question 16 – Reinsurance

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

Not only is the proposed guidance on reinsurance incomplete, we believe that reinsurance has not been adequately considered in other aspects of the measurement and presentation of insurance contracts. As the Boards re-deliberate the proposed guidance, we encourage you to consider the potential effect of reinsurance on all elements of the accounting standard. We offer the following thoughts for your consideration.

Residual/composite margin

We are concerned that the measurement of reinsurance ceded does not fully reflect the underlying economics of the business, particularly in relation to the measurement and amortization of the residual or composite margin of a reinsurance asset. The measurement of assets and liabilities should be based on consistent principles. Thus, the liability net of reinsurance asset reported by the cedant should value the obligation that economically stays with the cedant after reinsurance.

The ED currently provides for the following steps:

1. Value the underlying insurance contract; if the value is negative, reflect the loss immediately.; if the value is positive, defer the gain by creating an offsetting margin.
2. Value the reinsurance; if the value is positive to the cedant (i.e. the PV of payments to the reinsurer are less than the PV of payments from the reinsurer), reflect the gain immediately; if the value is negative (i.e. the PV of payments to the reinsurer are greater than the PV of payments from the reinsurer), defer the loss by creating an offsetting margin. *[Note that reinsurance treatment is the opposite of the treatment for the insurance contract.]*
3. Amortize any margin from the insurance contract over time in proportion to the timing of expected **insurance** benefits (IASB method) or expected **insurance** benefits plus **insurance** premiums (FASB method).
4. Amortize any margin from the reinsurance contract over time in proportion to the timing of expected **reinsurance** benefits (IASB method) or expected **reinsurance** benefits plus **reinsurance** premiums (FASB method). *[Note that the amortization of the reinsurance margin may be on a different basis than the amortization of the insurance margin.]*

The ED requirement to recognize a reinsurance gain immediately and to defer a reinsurance loss may not work well in every situation. It is a normal expectation that reinsurance will have a cost to a cedant, so that the present value of reinsurance cash flows will be negative. In a scenario where the underlying insurance contract has a positive present value, and the reinsurance thereon has a negative present value, the treatment of margins in the ED produces a reasonable result. However, it is also possible for the present value of reinsurance cash flows to be positive. This may occur, for example, if the reinsurer has priced the reinsurance with an expectation of lower claim experience than that assumed by the cedant. In this situation, the ED guidance on the calculation of margins will cause the PV of the calculated reinsurance gain to be recognized by the cedant immediately at inception of the reinsurance.

One may view this as the appropriate result, using the principle that since the reinsurance is a completed contract at inception and the cedant is irrevocably entitled to its value, the gain should be immediately recognized. However, this is inconsistent with the proposal to defer any loss on reinsurance. In any event, whether the initial measurement of the reinsurance predicts a gain or a loss, the actual development of the reinsurance value is sure to differ from the measurement at inception. It seems inconsistent to treat one situation differently from the other.

The following are some examples of other problems which may arise.

- The FASB proposal to amortize the margin (either risk/residual or composite) of the ceded business using the reinsurance premium leads to a misleading presentation. In most cases (i.e. when the reinsurance premium is not exactly the same as the respective premium of the underlying business), the amortization of the direct margin will be on a different schedule than that of the reinsurance margin. Therefore, users may not have a full understanding or appreciation of the relationship between the direct business and the portion of the cedant's business reinsured.
- When reinsuring an in-force block, the reinsurance margin and its amortization will be determined using cash flows discounted with a rate that is dependent upon interest rate scenarios at the time of reinsurance, which will be different from that of direct business. The direct business and the reinsurance contract will each have a margin that was determined using discount rates relating to the periods in time when it was written. The ED proposal to recognize any reinsurance gain and defer any reinsurance loss through the establishment of a margin may work when the cession under a reinsurance contract is contemporaneous with the direct business. However the result upon reinsurance of in-force blocks may not reflect the intent.
- For non-proportional reinsurance contracts, the attachment points related to the risk are different from the underlying direct business. Hence the proposed guidance to defer the loss through a margin or recognize a gain may not be appropriate as there is no symmetry in the economics between the underlying direct business and the risks that are ceded.
- Arrangements such as funds withheld are often used as collateral for the performance by the reinsurer. However, that affects the timing of the cash flows at inception, especially in case of an in-force block of business. Subsequently the amounts are periodically net settled along with interest, which may be a specific rate or based on the performance of a portfolio of investments. Because discount rates may be different from the Funds Withheld Interest, a "funds withheld" arrangement could result in a different margin from an economically equivalent full cash reinsurance arrangement.
- It is likely that there will be occasions when the insurer's portfolio consists of long-duration contracts measured using the current fulfillment value and the reinsurance contract qualifies for the premium allocation approach or visa versa. It is unclear how to apply the proposed guidance in this case.

We believe that an alternative approach to the measurement of ceded reinsurance will produce a financial statement more consistent with the true economics of the transaction. In the absence of an accounting model that recognizes all gains and losses at issue, a better result is obtained by establishing a margin after determining the combined net gain or loss from the direct and ceded cash flows, and to then determine the value of the reinsurance asset as the difference in the cash flow model with and without reinsurance. The steps listed above would be changed to the following.

1. Value the insurance obligations net of reinsurance by discounting fulfillment cash flows of the insurance and reinsurance combined. If the combined value is negative, reflect the loss immediately. If the combined value is positive, defer the gain by creating an offsetting margin.
2. Amortize the margin over time in proportion to the timing of expected net benefits after reinsurance (IASB method) or expected net benefits plus premiums after reinsurance (FASB method).

3. Value the insurance obligations (without reinsurance).
4. Record the reinsurance asset as the difference between the value with and without reinsurance.

This alternative method will work well in all four possible scenarios, whether the direct business has a PV gain or loss at inception and whether the reinsurance contract has a gain or loss at inception. It preserves the ED principles by deferring any combined gains and recognizing any combined losses at inception.

Appendix A contains a set of examples intended to highlight these issues. Four scenarios were constructed:

- Scenario 1 Direct contract with a *gain* at inception and 70% coinsurance with reinsurance *loss* to cedant at inception:
- Scenario 2 – Direct contract with a *gain* at inception and 70% coinsurance with reinsurance *gain* to cedant at inception:
- Scenario 3 – Direct contract with a *loss* at inception and coinsurance with reinsurance *loss* to cedant at inception:
- Scenario 4 – Direct contract with a *loss* at inception and coinsurance with reinsurance *gain* to cedant at inception:

The four scenarios are used to assess the financial impact of the IASB proposed guidance in the ED compared to three alternative methods. The insurer enters into reinsurance to manage its insurance risk. The challenge is to select a method that best reflects the economics and management's objectives in entering into a reinsurance arrangement.

Alternative Method 1- A combined gain is deferred; a combined loss recognized. Under this method, a combined gain over the life of the contract is deferred and a margin is established that would be amortized over the life of the contracts in a consistent way. If the combined effect is an expected loss, the loss is recognized immediately and no margin would be established.

Alternative Method 2 – Both reinsurance gains and losses are immediately recognized: The rationale for this method is that the insurer is irrevocably passing all or part of the insurance risk to the reinsurer and therefore should reflect the entire result immediately. While this method may be viewed as conceptually sound, when combined with the deferral of gain on the underlying direct insurance, the financial result is least reflective of the economic reality and would produce misleading financial information for users. While this alternative was included to show the range of possibilities, we do not support this Method for the stated reasons.

Alternative Method 3 – Both reinsurance gains and losses are deferred: This method is based upon the view that management enters into reinsurance as a way to manage insurance risk. Therefore, all expected gains or losses should be deferred and recognized over the life of the reinsurance contract as the reinsurer is released from risk.

Although Alternative Method 1 (the combined method) has the most logical results, it unfortunately has considerable drawbacks. It is administratively very difficult to match the direct and reinsurance measurement models to create a combined margin and amortization schedule. Also, reinsurance of a block of business may be purchased subsequent to the inception of the underlying direct business. Guidance would be necessary for adjusting the margin originally established for the underlying direct insurance.

Alternative Method 3 is a simpler approach that continues to value the direct business and the reinsurance separately, but with the more consistent approach of deferring both reinsurance gains and reinsurance losses.

It also produces fairly logical results. We look forward to the opportunity to discuss with the Boards the pros and cons of each of the methods discussed above to value ceded reinsurance. We believe it is important to find a method that presents the true economics of the transactions in financial statements.

Acquisition costs

We believe that the ED has not fully articulated guidance for the treatment of acquisition costs for reinsurance contracts. The treatment of the costs incurred by the reinsurer should parallel the treatment of acquisition costs for the insurer. Thus the reinsurer's costs including, but not limited to, costs related to marketing and underwriting should be considered acquisition costs.

We support the recently issued FASB guidance in ASU 2010-26 for determining the acquisition costs to be included in the measurement of the reinsurance contract liabilities. The FASB guidance more appropriately reflects the economics of the insurance business because it clearly identifies the direct costs to be included in the measurement model and because it defines acquisition costs on a portfolio basis rather than an individual contract basis in order to harmonize with other aspects of the measurement model.

Ceding commissions and allowances are an integral component of the economic obligations of the parties under a reinsurance agreement, and therefore should be included as cash flows in the measurement models. Paragraph 46 of the ED states that the cedant shall treat ceding commissions it receives as a reduction of the premium ceded to the reinsurer. In many cases this will produce the proper result, but the guidance would be more general and all-inclusive if it treated ceding commissions and allowances as separate cash flow items for both the cedant and the reinsurer, without regard to the premium. In some cases, for example, it is possible for the ceding commission to exceed the premium.

Premium allocation approach - Short-duration contracts

The ACLI believes that typical US YRT (yearly renewable term) reinsurance should be treated as long term and therefore not subject to a Modified Model, if one is adopted.

While the name of this form of reinsurance suggests that the reinsurance will renew and presumably be renegotiated or reset every year, this form of reinsurance is sold on a basis that is much longer term than one year. A typical YRT treaty will include a schedule of current, non-guaranteed premium rates as well as a guaranteed schedule of maximum premium rates. Generally, the reinsurer will have the right to adjust the non-guaranteed premium rates effective on each of the policy's next anniversary. However, the treaty will generally also provide for certain options to the cedant in a situation where the reinsurer changes rates. Therefore, it is very rare for rates to be changed, even with normal fluctuations in mortality experience over time. These schedules do not last for just one year but rather are determined and articulated in a manner that is intended to last for "life".

Further, the guaranteed premium rates in a typical YRT treaty have commercial substance. In a situation where there is a mortality pandemic or severe mortality scenario, the re-pricing right will provide for more revenue to the reinsurer but generally will not be sufficient to ensure that the reinsurer has a profit. Consequently, we believe the criterion is met for a typical YRT reinsurance treaty to be treated as long term, and we respectfully request confirmation of this point and further clarity in the guidance.

Contract boundary principle

Paragraph 13 of the exposure draft states- "An insurer shall recognize an insurance contract liability or an insurance contract asset when the insurer becomes a party to the insurance contract." Paragraph 14 states- "An insurer becomes a party to an insurance contract on the earlier of the following two dates:

- (a) when the insurer is bound by the terms of the insurance contract, and
- (b) when the insurer is first exposed to risk under the contract, which is when the insurer can no longer withdraw from its obligation to provide insurance coverage to the policyholder for insured events and no longer has the right to reassess the risk of any particular policyholder and, as a result, cannot set a price that fully reflects that risk.”

A common industry practice is to enter into reinsurance contracts to reinsure future new business. For example, an insurer will enter into a contract with a reinsurance company to reinsure 50% of life insurance sales for the next two years. The insurer has not issued any individual policy but both the insurer and reinsurer will be legally bound by the terms of the reinsurance contract. We believe that paragraph 14(a), as written, may result in a requirement to value reinsurance and to reflect the impact in financial statements before the policies covered by the reinsurance are issued. If this consequence is unintended, then we are raising the matter so as to harmonize the written requirements with the intent. We recommend that an insurer recognize a reinsurance contract liability or a reinsurance contract asset when the direct policy is written – when the risks attach for the insurer.

Paragraph 14(b) also raises a potential issue. Yearly renewable term reinsurance as sold in the United States usually obligates the reinsurer to remain at risk for the entire life of the covered direct insurance policy, with provision for limited rights to increase rates. The language in paragraph 14(b) may imply that a YRT contract is not recognized in the calculation of reinsurance assets and liabilities because of the right to increase rates. Additional guidance may be required to clarify that the accounting for the direct insurance liability and the YRT reinsurance recoverable should have the same boundary.

Definition of Risk Transfer

We agree with the overall definition of risk transfer in the ED. However, we have several suggestions for improvement.

1. The guidance should be clarified to incorporate the current US GAAP safe harbor, which provides that risk transfer should be deemed if the reinsurance agreement transfers substantially all the insurance risk in the portion of the insurance contract reinsured, and that analysis may be simplified when risk transfer is reasonably self evident.
2. More guidance on the meaning of “significant additional benefits” is necessary. What amount is “significant”? Paragraph B24 seems to be somewhat internally inconsistent, since it describes the word “significant” to include amounts that are a small proportion of the present value of the total cash flows. Reinsurance may need separate guidance for the definition of “significant”, since the smallest unit of account for reinsurance – in contrast to primary insurance – is a single reinsurance treaty. It is already a portfolio of single policies which in many cases benefits from diversification effects. Consequently, reinsurance contracts often produce relatively stable expected results (i.e. only a small range of possible outcomes) and the probability of a loss (i.e. present value of net cash outflows exceeding the present value of net cash inflows) is relatively low.
3. Paragraph B28 of the ED advises that for the purpose of assessing the risk transfer, “contracts entered into simultaneously with a single counterparty, or contracts that are otherwise interdependent, form a single contract”. In consequence, this could imply that fronting, retrocession and reinsurance programs might be excluded from the scope of the future standard on insurance contracts. It should be made clear that fronting, retrocession and reinsurance programs are not “contracts that are otherwise interdependent” in the sense of paragraph B28 of the ED and consequently, the underlying insurance contracts and the ceded and assumed reinsurance contracts shall be assessed independently for risk transfer.

4. In addition, it should be made clear that risk transfer assessment of a contract is made only once, i.e. at inception. This also implies that no reassessment of the existing portfolio should have to be done at the date of transition since these contracts have already been subject to strict risk transfer rules.

5. If the reinsurance fails to meet the risk transfer requirements, the guidance should reference the IFRS to be applied to the contract, e.g., IFRS 9.

Scope

We wish to confirm that reinsurance between affiliated insurers is not scoped out by Paragraph 4(g) of the ED:

4 An entity shall not apply this [draft] IFRS to:

(g) direct insurance contracts that the entity holds (ie direct insurance contracts in which the entity is the *policyholder*). However, a *cedant* shall apply this [draft] IFRS to reinsurance contracts that it holds.

Unbundling

In addition to concerns with respect to direct business communicated in our earlier letters, we have concerns with the impact that unbundling will create for modified coinsurance and funds withheld reinsurance treaties. Unbundling of reinsurance agreements will generally result in a presentation that is not helpful to the users of financial statements.

FASB published Derivatives Implementation Group Statement 133 Implementation Issue No. B36 in 2003 regarding bifurcation of embedded derivatives in Modified Coinsurance Arrangements incorporating credit risk exposures that are unrelated to the creditworthiness of the obligor. The ACLI disagreed with the unbundling required by this guidance, and continues to disagree with such a conclusion under the IASB Exposure Draft.

Modified coinsurance agreements are often very complex arrangements. In a common modco reinsurance agreement, cash flows, payables and receivables are based upon a net calculation of many items such as premiums, investment returns on a reference block of invested assets, benefit payments, expenses, changes in liabilities, and profit sharing, generally all determined on a statutory basis. All of these items affect the cash flows under the agreement and are intertwined, with changes to any single item resulting in a change to the amounts due. The Exposure Draft language may be interpreted to require unbundling because one component of the cash flow determination under the contract requires reference to the investment returns on a specific pool of invested assets. We believe that the modco agreement is the host contract in this situation, and that the mechanics of the agreement leads to the conclusion that the potential embedded derivative is clearly and closely related to the host contract, and thus not subject to bifurcation.

In reaching this conclusion, it is also important to remember that the reference pool of assets in the modco reinsurance arrangements remain assets of the cedant, subject to all otherwise applicable accounting guidance. Thus, even without unbundling, the assets referenced in a modco agreement will be treated comparably in financial statements to similar assets transferred to a reinsurer under a typical coinsurance agreement.

Disclosures

We believe that the requirements in Paragraph 92 to disclose information about the sensitivity to insurance risk before and after risk mitigation by reinsurance are too technical and detailed to be useful to users of financial statements. We are also concerned that the guidance may require disclosing proprietary

information. For example, the disclosures include qualitative information about risk exposures and risk management techniques and methodologies based on information provided internally to key management personnel. These requirements may be crossing the line between useful information and confidential information. We suggest that instead of being prescriptive, the disclosure requirements regarding risk mitigation be more general and be principle based.

In addition, we suggest that the requirement in Paragraph 94 to disclose information about the credit quality of reinsurance assets is problematic. As described in our response to Question 16 below, valuation of reinsurer credit risk is complex; reinsurer credit risk is neither reasonably certain nor reasonably estimable; and the expected value is close to zero in any event. Aside from publicly available information, a cedant has very little ability to make such an assessment unless a reinsurer is in default.

Symmetry

We would like to comment on the symmetry of assumptions in the measurement of insurance and its associated reinsurance since we believe there may be confusion about its application. We believe that symmetry within an insurer is appropriate. The assumptions and methods used to value insurance and the reinsurance contracts thereon should be parallel.

However, we strongly disagree that there should be a commonality of assumptions between the insurer and reinsurer. There are many reasons why inter-company symmetry is incorrect. First, timing difference between the insurer and reinsurer will by itself cause differences. Second, non-proportional contracts (such as stop loss covers) have very different economics than the underlying business. Third, there is often a different investment strategy, aggregation philosophy for mortality management, or other product management decision that will result in different views and/or expectations on performance for the reinsurer and the cedant. Forcing either party to accept the other's views will create a lack of homogeneity in that company's financial statements that will tend to cause confusion and will not be a faithful representation of the business. For these reasons we believe that each entity should reflect the value it ascribes to its block of business, and that guidance should be clear on this point.

Conclusion

We thank you in advance for your kind consideration of our comments.

Sincerely,

A handwritten signature in black ink, appearing to read "M Monahan", written in a cursive style.

Michael Monahan

Cc: Jennifer Weiner, FASB staff
Andrea Pryde, IASB staff
Sandra Hack, IASB staff

Appendix A: Illustrations of reinsurance contracts

The illustrations in this appendix were developed to enhance the understanding of the potential effect of various reinsurance scenarios on financial results. The examples are simplified to focus on possible outcomes at inception when the insurer enters into a reinsurance contract. As part of the simplification, the risk adjustment is assumed to be zero with the margin representing either the residual or composite margin. The following four scenarios form the basis of our analysis:

	<u>Direct Contract-at inception</u>		<u>70% Coinsurance-at inception</u>	
	<u>Gain</u>	<u>Loss</u>	<u>Loss</u>	<u>Gain</u>
Measurement of Liability:				
1. PV of future benefits	1,400.0	1,400.0	(980.0)	(980.0)
2. PV of future expenses	1,000.0	1,000.0	(700.0)	(700.0)
3. PV of future premiums	<u>(2,500.0)</u>	<u>(2,300.0)</u>	<u>1,750.0</u>	<u>1,660.0</u>
4. PV of fulfillment cash flows	(100.0)	100.0	70.0	(20.0)
5. Gain/(loss)	<u>100.0</u>	<u>(100.0)</u>	<u>(70.0)</u>	<u>20.0</u>

Scenario 1 – Direct contract with a *gain* at inception and 70% coinsurance with reinsurance *loss* to cedant at inception:

This scenario could be viewed as a typical reinsurance arrangement where the insurer expects a gain of \$100 at inception and shares proportionately the expected earnings of \$70 with the reinsurer.

Scenario 2 – Direct contract with a *gain* at inception and 70% coinsurance with reinsurance *gain* to cedant at inception:

This scenario may result if the pricing by the reinsurer is different from that of the insurer. For example, the insurer estimates the present value of the future benefits to be \$1,400 with the reinsurer's share amounting to \$980. However, the reinsurer may price the future benefits to be \$900 and therefore charges a premium of \$1,660, resulting in an expected gain to the insurer of \$20.

Scenario 3 – Direct contract with a *loss* at inception and coinsurance with reinsurance *loss* to cedant at inception:

This scenario assumes that the insurer would experience a loss of \$100 at inception and enters into a reinsurance contract where the reinsurer's pricing is the same as the reinsurance example in scenario 1.

Scenario 4 – Direct contract with a *loss* at inception and coinsurance with reinsurance *gain* to cedant at inception:

This scenario combines the direct contract with a loss from scenario 3 with the reinsurance example from scenario 2.

The four scenarios are used to assess the financial impact of the IASB proposed guidance in the ED compared to three alternative methods.

IASB Method

Under the proposed guidance, reinsurance losses are deferred and gains recognized at inception of the reinsurance contract.

Alternative Method 1- Combined Gain deferred; Combined Loss recognized

This alternative assesses the combined effect of the direct and reinsurance contract. Under this method, if the combined expected result is a gain, a margin would be recognized for both the direct and reinsurance contract, effectively deferring the net gain. If the combined result is a loss, no margin would be recognized for either the direct or reinsurance contract and a net loss recognized at inception.

Alternative Method 2 - Reinsurance Gain or Loss Recognized

Under this alternative, reinsurance gains or losses would be recognized immediately, thereby resulting in no margin under the reinsurance contract.

Alternative Method 3 - Reinsurance Gain or Loss Deferred

Method 3 defers all reinsurance gains or losses.

**MEASUREMENT OF REINSURANCE
 ILLUSTRATION OF FOUR POSSIBLE SCENARIOS**

Scenario:	#1 Direct Gain <u>Reins. Loss</u>	#2 Direct Gain <u>Reins. Gain</u>	#3 Direct Loss <u>Reins. Loss</u>	#4 Direct Loss <u>Reins. Gain</u>
IASB Method – at inception				
<u>Direct-Gain deferred, Loss recognized; Reinsurance-Gain recognized, Loss Deferred</u>				
<u>Direct</u>				
PV of fulfillment cash flows	(100)	(100)	100	100
Margin	<u>100</u>	<u>100</u>	<u>0</u>	<u>0</u>
Liability	0	0	100	100
<u>Reinsurance</u>				
PV of fulfillment cash flows	70	(20)	70	(20)
Margin	<u>(70)</u>	<u>0</u>	<u>(70)</u>	<u>0</u>
Reinsurance Asset	0	20	0	20
Gain (Loss) at inception	0	20	(100)	(80)
Alternative Method 1				
<u>(Combined Gain deferred; Combined Loss recognized)</u>				
Direct -Margin	100	100	(100)	(100)
Reins - Margin	<u>(70)</u>	<u>20</u>	<u>(70)</u>	<u>20</u>
“Combined” Gain (Loss)	30	120	(170)	(80)
“Combined” Margin	<u>30</u>	<u>120</u>	<u>0</u>	<u>0</u>
Gain (Loss) at inception	0	0	(170)	(80)

Scenario:	#1 <u>Direct Gain</u> <u>Reins. Loss</u>	#2 <u>Direct Gain</u> <u>Reins. Gain</u>	#3 <u>Direct Loss</u> <u>Reins. Loss</u>	#4 <u>Direct Loss</u> <u>Reins. Gain</u>
Alternative Method 2				
<u>Reinsurance Gain or Loss Recognized, i.e., no reinsurance margin</u>				
Direct				
PV of fulfillment cash flows	(100)	(100)	100	100
Margin	<u>100</u>	<u>100</u>	<u>0</u>	<u>0</u>
Liability	0	0	100	100
<u>Reinsurance</u>				
PV of fulfillment cash flows	70	(20)	70	(20)
Margin	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Reinsurance Asset	(70)	20	(70)	20
Gain (Loss) at inception	(70)	20	(170)	(80)
Alternative Method 3				
<u>Reinsurance Gain or Loss Deferred</u>				
Direct				
PV of fulfillment cash flows	(100)	(100)	100	100
Margin	<u>100</u>	<u>100</u>	<u>0</u>	<u>0</u>
Liability	0	0	100	100
<u>Reinsurance</u>				
PV of fulfillment cash flows	(70)	20	(70)	20
Margin	<u>70</u>	<u>(20)</u>	<u>70</u>	<u>(20)</u>
Asset	0	0	0	0
Gain (Loss) at inception	0	0	(100)	(100)