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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 – Presentation

Dear Sir David Tweedie and Ms. Leslie Seidman:

The American Council of Life Insurers (ACLI) is pleased to share with you additional views regarding issues related to presentation discussed at the March 2011 Board meetings; specifically related to staff paper 3A/59H - Alternative Presentation Models. We continue to support our recommendations expressed in our February 11, 2011 letter:

An entity shall evaluate the terms of the insurance contract and its customary business practice to identify all insurance rights and obligations and shall present information in the financial statements consistent with the nature of the contracts and the way the business is managed.

An entity shall recognize revenue representing the amount of the transaction price, i.e., customer consideration, when due for contracts measured at current fulfillment value and earned for contracts measured under the premium allocation approach.

After listening to the Boards' discussions, we noted that Board members tended to focus on the following issues and concerns:

- Revenue for insurance contracts should be consistent with the proposed model contained in the Revenue Recognition Exposure Draft (ED).
- If premiums are recognized as revenue, they should be accounted for on an earned basis.
- The change in liability illustrated in some of the examples is presumed to be a plug.

Our response addresses each of these issues and concerns.

Consistency with the Revenue Recognition Model

Insurance contracts are expected to be scoped out of Revenue Recognition, which we support because insurance is fundamentally different from contracts that would be subject to the Revenue Recognition guidance for the following key reasons:

- The unit of account for insurance contracts is a portfolio whereas the unit of account under Revenue Recognition is a single contract.¹

¹ Paragraph 8 of the ED states: "An entity shall apply the proposed guidance to *each contract* (emphasis added) identified in accordance with paragraphs 9-19."

- The measurement of contracts under the ED is based upon the fundamental concept of a performance obligation while the measurement of insurance contracts is based upon a stand-ready obligation. Customers/policyholders buy long-duration insurance contracts to transfer risk, i.e., the risk of dying too soon, living too long or becoming disabled.

To expect the same outcome for contracts accounted for under the Revenue Model and the Insurance Model, which is fundamentally different, is inconsistent with the nature of business. Therefore, we do not believe the Boards should attempt to align the two standards but rather, recognize their differences.

Premiums as revenue

Some Board members expressed support for an "earned" approach for the recognition of premiums as revenue. The ACLI believes the recognition of premium when due, for long-duration contracts, is superior over the earned approach for the following reasons:

- The due approach is consistent with the measurement of the insurance contract liabilities and the building blocks approach because premiums would be recognized consistent with the unwinding of the cash flows-premiums
- The due approach is consistent with the Conceptual Framework:
 Recognition of income

4.47 Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).²

- The earned approach would require allocating premiums over the coverage period for all long-duration contracts not only when the premium paying period differs from the coverage period but also for level premium paying contracts because the view is that policyholders pay more in the early years and less than required in later years with the excess in the early years being a deposit. Not only will the earned approach add complexity, in our opinion, it would not be a faithful representation of the business nor provide useful information to users.
- Analysts tend to use non-GAAP measures for volume information to supplement GAAP financial statements. In the U.S., analysts use regulatory information, i.e., statutory reporting, that reports premiums as revenue in accordance with the contractual terms of the contract, which aligns with the premium due approach for long-duration contracts.

To illustrate our concern, consider the effect on a portfolio of 10 year term contracts, which we illustrated in our October 26, 2010 letter to the Boards addressing explicit margins. At inception, the present value of the expected premium cash inflows for the portfolio was 2,484.3. At the end of the first year the estimate was 2,162.4. Under the "when due" approach for the recognition of premium revenue the recognized amount of revenue would be \$415.0, which is measured as follows:

Present value of estimated premiums at inception:	2,484.3
Interest on the estimated premiums	93.1
Release of premiums due	<u>(415.0)</u>
Present value of estimated premiums end of year 1	2,162.4

It is unclear what the amount would be under an earned approach. In addition, it is unclear how it would

² Extracted from Framework for the Preparation and Presentation of Financial Statements. © IASC Foundation.

be reported without it resulting in double counting or unbundling.

Change in liability

Some Board members view the "Change in Liability" in the expanded margin model as a plug. This view is understandable given the historical perception that financial statements of insurance entities are opaque and confusing, especially as it relates to the lack of disaggregation of the components of the change in insurance reserves. We are well aware of this perception and concur with the Boards that a more robust presentation model would increase transparency and usefulness. The Summarized Margin presentation approach, however, falls short of achieving this objective. Although the Summarized Margin approach improves transparency by providing information about the impact on earnings from the release of margins, gains and losses at initial recognition, experience adjustments and changes in estimates, and interest on insurance contract liabilities, the removal of the key metrics, premiums, benefits, claims, and expenses from the Performance Statement results in a decrease in transparency and usefulness. Continuing to provide the key metrics in the Performance Statement is essential to a presentation model that follows the management approach, which will allow users to view the statements "through the eyes of management."

We disagree with the assertion that the "change in liability" used in the Appendix A-4 Expanded Margin Approach examples is a plug. Yes, the change in liability has many debits and credits that make up the amount. As evidenced in Appendix B-1 of the March 2011 staff paper 3A/59H, the change in the insurance liability is determined as the sum of the cash flow items of premiums, claims and benefits, incremental acquisition costs, and expenses. Each of these items would be required to be disclosed in the reconciliation of contract balances specified in paragraphs 86 through 89 of the IASB ED, and therefore the basis for determining the "change in liability" amount will be discernable from the required reconciliation disclosures.

Alternative presentation models

The Statement disclosure approach, Appendix A-3, is not an approach we support. Moving volume information to the Performance Statement and placing it within a box is not an approach that meets the reporting objective. We find this approach confusing and difficult to understand since the reported premiums, claims and expenses are only informational and not used within the Statement.

Likewise, we do not support the Expected cash flows approach, Appendix A-5. Of all of the alternatives, this one is the least useful. Presenting the entire expected undiscounted value of cash inflows and outflows within the statement is misleading and does not provide decision useful information. It is misleading in that it places greater importance on new business. Premiums and claims information are relevant for new business and existing business. We are not aware of any metric used by analysts that is based solely upon the expected value of new business.

While the Dual statement approach attempts to incorporate a source of earnings concept into the Statement, it is overly complex and does not represent the source of earnings of the entity. The drivers of performance come from investment and insurance activities.

The Appendix A-4, Expanded Margin Approach examples are similar to the ACLI recommended approach outlined in our February letter and we believe these presentation examples most faithfully represent the nature of the business. We note that the three subsets in this example, 4a, 4b, and 4c, represent minor differences in presentation style. We encourage the Boards not to be too prescriptive with its guidance about the presentation approach. We do believe however that one way to enhance reporting is to group the interest on insurance liabilities with the investment activity.

In conclusion, we support the Expanded Margin Approach, which aligns with our prior recommendation.

We reiterate that volume information is an essential part of Comprehensive Income with premiums recognized in revenue when due for long-duration contracts and earned for short-duration contracts. The principles outlined in our February letter should serve as foundational for the development of guidance about presentation.

Sincerely,

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

cc: Warren McGregor, IASB Board
Marc Siegel, FASB Board
Jennifer Weiner, FASB staff
Andrea Pryde, IASB staff
Peter Clark, IASB staff