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September 6, 2011

Ms. Leslie Seidman Chairman Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856 United States

Subject: Accounting for Short-duration Non-life Insurance Contracts

As a trade association representing the Chief Financial Officers of insurance companies in North America, members of the Group of North American Insurance Enterprises (GNAIE) listened with great interest to the FASB's August 31st Education Session on the accounting for short-duration (typically non-life) insurance contracts. We were very encouraged by the discussion that focused on the unique attributes of short-duration non-life insurance contracts and the needs of investors.

While we support the general direction of the discussions, following are topics for which we would like to provide the Board additional information before they are discussed in more detail at its September 7th meeting:

- Discounting
- Revenue and Profit Recognition
- Probability-Weighted Cash Flows
- Eligibility Requirements

We write this letter within the following context. We continue to support the objective of creating a comprehensive high-quality global accounting and financial reporting framework that includes insurance contracts. We believe a global accounting and reporting framework requires accounting standards that are capable of global implementation, attain a high degree of comparability for similar transactions, are understandable, and meet the needs of investors as required by the FASB Conceptual Framework.

Jerry M. de St. Paer Executive Chair

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We note that most investors around the globe are satisfied with the measurement and reporting of short-duration non-life insurance contracts currently in place and generally oppose proposals to introduce explicit risk adjustments, discounting, and new eligibility requirements. They believe the changes would:

- increase the non-economic volatility of reported results for reasons outside the control of management,
- make operating performance less comparable and less understandable, or
- are otherwise unnecessary (e.g., modified eligibility requirements) as no practice issues currently exist.

Investors believe the proposed modifications may result in the global insurance industry becoming less attractive as an investment thus causing the industry's cost of capital to rise. This would have detrimental impacts not only on the global insurance industry but also on the customers it serves, causing either higher prices or lack of availability of certain insurance products.

Consistent with the discussion at the Educational Session, GNAIE, along with other representatives of the non-life insurance industry have called for separate models, one for short-duration non-life insurance contracts, and one for long-duration life insurance contracts. Investors, analysts, and preparers around the globe also agree that the underlying businesses are fundamentally different. Therefore, requiring application of a single model for both short-duration and long-duration insurance contracts would produce information that is not comparable, understandable, decision-useful nor reflective of a high quality global accounting standard.

In support of a two-model approach, investors, analysts, and preparers have consistently supported the continued use of the model currently in place in most of the world for short-duration non-life insurance contracts. For this document, we refer to this as the second model.

- · It does not include explicit risk adjustments or discounting,
- It has proven extremely reliable in the decades it has been in place.
- It has already achieved global implementation,
- It promotes comparability,
- It is understandable, and
- It is consistent with the business model of insurers who issue short-duration nonlife insurance contracts.

In short, it possesses *all* the key attributes of a high-quality global accounting standard.

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We appreciate both Boards' outreach activities and the opportunity to be included in the discussions related to the development of the insurance contracts standard. As the boards and staff continue their work on this important joint project we stand ready to assist in any capacity you believe will be helpful to the successful conclusion of the project in a manner that meets the needs and objectives of a global accounting framework.

Sincerely,

Kevin A. Spataro

Kevin ppataro

Chair, GNAIE Accounting Convergence Committee

cc: FASB Board Members

Hans Hoogervorst

Peter Clarke Andrea Pryde Jennifer Weiner

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Appendix

I. Discounting Short-Duration Property-Casualty Insurance Contracts

The IASB Exposure Draft for Insurance Contracts proposed a measurement model that requires discounting in the measurement of claim reserves. Based on discussions with investors, analysts and preparers, the general consensus is that introducing discounting into the measurement and reporting model for short-duration non-life insurance contracts would neither improve current U.S. GAAP accounting nor result in a global accounting standard that provides comparable, understandable, decision-useful information to investors. Moreover, investors believe the proposed model would reduce their ability to understand an insurer's operating performance and financial condition.

The basic objective for a measurement and reporting model for short-duration non-life insurance contracts should be to provide information in a way that best facilitates investors' understanding of the insurer's operating performance and financial condition. Investors believe the use of undiscounted measures on the same basis as used internally by insurers to manage their business provides the most relevant, transparent and decision-useful information to assess an insurer's operating performance and financial condition.

Determining the amount of, and periodic changes in, claim reserves is a critical element of financial reporting for insurers that write short-duration non-life insurance contracts. As such, investors are best served by the most transparent view of the insurer's expected actual costs to settle claims. The use of discounting (and risk adjustments) in the measurement of claim reserves obfuscates` the true picture of management's ability to predict ultimate claim settlement costs. The following points summarize the importance of measuring short-duration non-life insurance contracts on an undiscounted basis:

- The existing measurement of claim reserves on an undiscounted basis without explicit risk adjustments is based on actuarial guidelines where the measurement objective is typically an expected value (of actual amounts expected to be paid) over the range of reasonably possible outcomes. While these estimates, like all estimates, are subject to continuous revision as actual claim experience emerges, there is no evidence that introducing discounting or risk adjustments would increase the precision of claim reserve estimates.
- Investors are aware of the risks of under-reserving for claims (the leading cause of property-casualty insurer insolvencies) which they believe would increase with the introduction of discounting. Under-reserving results in losses when higher than expected claim payments are made. Moreover, if inadequate loss estimates are used in pricing future contracts, they may also lead to losses on future contracts.

- Claims typically emerge quickly for personal lines products (e.g., auto and homeowners)¹. The use of undiscounted claims estimates allows insurers to identifying frequency and severity trends earlier which allows them to be addressed more quickly; typically through pricing and underwriting changes versus modified investment strategies.
- While acknowledging money has a time value, the use of undiscounted actuarially estimated claim reserves, accompanied by appropriately designed loss development schedules, provides investors with the most transparent, decision-useful information for claim reserves.
- Investors and analysts have indicated that if claim reserves are discounted
 they would remove the effect of discounting to analyze actual claim
 development experience. Investors are concerned that the unwinding of the
 discount moves incurred losses to subsequent periods to which they do not
 relate and prevents the recognition of true adverse claim development
 experience.
- The use of discounting alters the profit recognition pattern on a portfolio of short-duration non-life insurance contracts by extending it over the claim payment period. Investors, analysts, and preparers believe that revenue and profits should be recognized over the coverage period as risk protection services are provided. This provides the most decision-useful presentation of the results of management's underwriting decisions, which is fundamental to the short-duration non-life business.
- While subsequent changes in undiscounted claim estimates may impact
 profits in future periods, they are reflected in claim development schedules
 and disclosures and are readily apparent to investors.
- Undiscounted claim estimates are used by insurer to manage their short-duration non-life insurance business. Undiscounted estimated claim information is available at a detail statistical level (coverage, deductible, territory, vehicle make/model, etc.), however, it would not be cost effective to produce this information on a discounted basis. Because insurers use undiscounted claim estimates to manage their business, the evaluation of performance is best presented on that same undiscounted basis.

¹ For auto and homeowners lines of business, claim payment development for the U. S. industry indicates that over 80% of payments are made by the end of 2 years following the loss year (95.6% for HO and 84.3% for Auto). For commercial multi-peril policies the 80% threshold is reached 3 years after the loss year. The impact of discounting for such reserves which pay out in such timeframes would not be significant to the overall evaluation of performance for these companies.

 The use of discounting requires additional metrics for incurred loss experience. In addition to paid losses and the change in claim reserves, the unwinding of the discount would need to be disclosed to calculate a useful incurred loss amount and loss ratio. This would be impractical at a detail product level and calls into question the usefulness of the information.

The additional metrics inherent in discounting include the use of a discount rate that relates to a current interest rate environment which is beyond the control of the insurer. A second metric is the selection of cash outflows (or payment) pattern, the selection of which is subjective and insurer specific. This prevents comparability to the detriment of statement users analyzing or evaluating more than one insurer for investment decision-making purposes.

Discounting short-duration non-life insurance contracts incorporates the anticipated impact of investing activities into the underwriting result. Specifically, initial claim reserves are reduced by the anticipated impact of future investment results. In future periods, claim reserves are accreted to the undiscounted amount of claims expected to be paid. The accretion expense is off-set by net investment income earned. Discounting thus mixes two separate and distinct operations of a property casualty insurer (i.e., underwriting and investing) which reduces investors ability to assess an insurer's primary business metric; i.e., underwriting.

- If discounting is mandated, existing measures (which would become non-GAAP measures) would likely continue to be used as they provide the most transparent, understandable, decision-useful information to investors about the operating performance and financial condition of the insurer. We do not believe a proliferation of non-GAAP measures is desirable.
- The benefits of discounting short-duration non-life claims are questionable given the uncertainty as to the timing and amount of claims; this is particularly true for reserves for claims in litigation, where the amount and timing of potential payments is highly uncertain and unpredictable. Any discounting of such reserves would not produce decision useful information for investors.
- A significant portion of reserves represent "Incurred but not Reported" ("IBNR") claims. These reserves are estimates of claims that have occurred but have not yet been reported to the insurer. Very little, if any, information about these claims is known. There would be a very high degree of uncertainty in scheduling out potential payment patterns for these claims necessary for discounting.

As described above, we believe the current U.S. GAAP measurement and presentation requirements (without discounting and explicit risk margins) provide a proven, reliable, decision-useful measurement of claim reserves for short-

duration non-life insurance contracts and provide the best information to investors about an insurers operating performance and financial condition. As such, we do not believe the introduction of discounting to the measurement of short-duration non-life insurance contracts would be an improvement to existing U.S. GAAP requirements nor would it be a desirable element of a high quality global accounting standard for short-duration non-life insurance contracts.

Notwithstanding the preceding, discounting would continue to apply to claim reserves that are fixed and determinable on an individual claim basis. (e. g. workers' compensation claims) since most of the issues described above do not exist with respect to those claims.

II. Revenue & Profit Recognition for Short-Duration Non-life Insurance Contracts

We listened to, and agreed with the discussion on revenue and profit recognition as it relates to short-duration non-life insurance contracts. Notwithstanding our support for the consensus reached we thought it might be useful to add some additional insights to the Board:

- Short-duration non-life insurance contracts are executory contracts that provide risk protection to policyholders over a predetermined coverage period. Because the contracts are executory, no insurance protection services are provided at inception, and thus no gain is recognizable at inception. All premium revenue is earned and all anticipated expenses and costs are recognized over the coverage period to provide for a consistent recognition of revenues and expenses. In addition, the unearned premium reserve is evaluated for adequacy at the end of each reporting period.
- Activities between the insured and insurer after expiration of the coverage
 period typically involve the insurer incurring costs to settle outstanding claims
 and not the extension of additional risk protection services to the insured.
 Because risk protection (i.e., the benefit purchased by the insured) is only
 provided during the coverage period for short-duration non-life insurance
 contracts no basis exists for deferring either revenue or profit recognition
 beyond the coverage period.

III. Probability Weighted Cash Flows

The description of the Boards' tentative decisions regarding mean expected estimates of cash flows is consistently articulated in both the FASB and IASB current project status summaries. As it relates to expected value, the Boards' tentative decisions are:

- The measurement objective of expected value refers to the mean that considers all relevant information; and
- Not all possible scenarios need to be identified and quantified, provided that the estimate is consistent with the measurement objective of determining the mean.

As it relates to short-duration non-life insurance contracts, claim reserves are typically computed by trained actuaries who apply actuarial guidelines and judgments that are subject to actuarial standards of practice. The relevant actuarial guidelines indicate that the measurement objective for claim reserve measurement is typically *an expected value over the range of reasonably possible outcomes*. Other relevant attributes of the actuarial estimates include the following:

- In addition to statistical models the actuary may apply actuarial methods that do not result in a statistical mean;
- The actuary considers factors, that in its professional judgment, are material and are reasonably foreseeable at the time of the estimation;
- The actuary considers external conditions including potential economic changes, regulatory actions, judicial decisions, or political or social forces.

We are generally supportive of the above description of the claim cash flow measurement objective (i.e., a mean that considers all relevant information) as contrasted with the ED language that would have required the estimate to include a "the full range of possible outcomes". For purposes of clarity, however, we suggest the wording around probability weighted cash flows be further enhanced to indicate that the mean value can be a "conceptual" mean as opposed to a strict "statistical" mean to take into account the fact that actuaries will likely utilize a variety of information to derive their estimate; all of which may not be statistical.

IV. Premium Allocation Approach or Second Model - Eligibility Criteria

Identifying eligibility criteria for the premium allocation approach ("PAA") or second model is an extension of evaluating the distinguishing characteristics of long-duration life insurance contracts and short-duration non-life insurance contracts.

We understand that some believe the differences between short-duration non-life insurance contracts and long-duration life insurance contracts are not sufficient to justify two different measurement models; that at the most general level both deal with uncertain cash flows. This group supports a single measurement model for all insurance contracts and considers the PAA an approximation of the building blocks ("BBs") to be used only when the coverage period is very short.

In contrast, others, including U.S. regulatory authorities and most investors and financial statement preparers in the U.S., believe the businesses associated with short-duration non-life insurance contracts and long-duration life insurance contracts are fundamentally different and warrant accounting measurement and reporting models that correspond with their unique characteristics.

FASB Staff, in developing eligibility criteria for a two model approach, identified the following:

- (a) compensation to the policyholder is based on the amount of the incurred insured loss which is typically variable up to the amount of the policy limit and not a specified amount (other than the limit) in any given contract;
- (b) the period of time between premium receipt and the date of loss is insignificant; and
- (c) the pricing of the premiums does not include risks relating to future renewal periods.

The Boards spent considerable time at their July 21st joint meeting debating the general issue of whether short-duration non-life insurance contracts are sufficiently different from long-duration life insurance contracts as well as the eligibility criteria that should determine which contracts would be eligible for the PAA or other second model.

While we believe the FASB was very thoughtful and thorough in the development of PAA eligibility criteria, those criteria might be enhanced, based on our understanding of the discussion at the July 21st meeting, by substituting the first criteria with the following:

The amount of premiums/revenues over the expected or contractual life of the insurance contract are typically known (typically true for short-duration non-life insurance contracts²).

[The preceding would contrast with long-duration life insurance contracts where the amount of premiums/revenues over the expected or contractual life of the insurance contract are typically unknown because it is not known when the insured will die, if the policy will lapse, or in the case of Universal Life premiums, their amount over time].

At the August 31st meeting, there was a continued discussion about certain products that seemingly have ambiguous characteristics such as one year **non**-renewable term life insurance. These contracts represent a very small fraction of the total insurance premiums written globally. Moreover, one year, non-renewable term life insurance is not a common offering in the U.S., nevertheless, in determining whether to apply either the BB model or second model we would look to the distinguishing characteristics identified in the HUB Group Business Model proposal. The characteristics most important to determining the appropriate measurement model for this contract would include:

Premium Allocation Approach or Second Model

- Primary risk exposure to frequency and severity of claims³;
- Primary performance analytical tool experienced-based claims development⁴;
- Premiums single and fixed⁵;
- Insurance risks re-underwritten and re-priced annually or more frequently;
- Claims emerge quickly; and
- Profitability issues would be addressed through pricing of future contracts versus modified investment strategies (i.e., not practical to meaningfully affect returns by changing short-term investment strategies).

² This would be true for single premium life and annuity contracts which we believe would not qualify for the PAA or second model as a result of failing the FASB's second criteria "the period of time between premium receipt and the date of loss is insignificant" – which could be true for an individual insurance contract but not a portfolio of insurance contracts.

³ Severity of claims could pose an issue as the criteria is "frequency <u>and</u> severity" and the fact that claim severity is not an issue for life insurance where the amount of exposure is defined in the policy. In addition, while claim frequency would be measured at a portfolio level is fundamentally different for long-duration life and short-duration non-life insurance contracts inasmuch as individual life contracts cannot have more than one event whereas non-life contracts can have multiple covered events during a coverage period.

⁴ The primary analytical tool for tracking the performance of such a product would likely be "mortality experience" which is a simplified version of claim development.

This would include situations where the amount of premium is adjusted based on actual usage factors that are not known until the end of the coverage period. This would be typical in the commercial trucking industry where "actual miles driven" (which is the basis of coverage) are not known with certainty until the end of the coverage period or in certain workers compensation policies where audit premiums are common based on actual payroll.

Building Block Model

- More granular asset-liability matching;
- Associated with long-duration contracts;
- Investment results a primary consideration;
- Primary risk investment, mortality and morbidity experience;
- Primary performance analysis tools margin analysis for investments, mortality, morbidity, persistency and actual to expected experience measures;
- Discretionary premiums may continue over coverage period;
- Dollar amount of insurance coverage specified in contract;
- Risks not re-underwritten or re-priced annually or more frequently

The attractiveness of adding the preceding criteria is that it helps distinguish between short and long-duration contracts in a simple, objective manner that is relatively easy to apply and would address the exceptions discussed at both the July 21st joint meeting and August 31st FASB Educational Session.