February 12, 2010

Technical Director
Financial Accounting Standards Board
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RE: File Reference No. EITF 09-G – Proposed Accounting Standards Update, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

We appreciate the opportunity to comment on the proposed Accounting Standards Update (“ASU”), Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. In general, we support the Board’s actions to revise the insurance accounting model through the Insurance Contracts project. However, we have concerns about making the changes proposed by this ASU at this time. In particular, we believe that a primary goal of GAAP should be to match accounting with the underlying economics of a business as closely as possible. We believe that the proposed changes in the ASU will result in different accounting treatment for costs that have the same economic substance, thereby adversely affecting the comparability of financial statements for companies within the property-casualty insurance industry. While we agree with the Board’s assessment that the insurance accounting model should undergo comprehensive review and revision, we believe that the changes proposed by the ASU will serve to make an already imperfect model worse.

The economic substance of marketing costs paid by an insurance company that utilizes a direct-to-consumer distribution system is essentially the same as marketing costs paid by those that use an independent agency distribution system. In a direct-to-consumer model, the insurance company uses advertising and other marketing initiatives to sell insurance policies directly to the consumer via phone or the internet. In an independent agency model, the insurance company pays an agency commissions for policies sold by the agency. The agency uses the commissions, which are typically its main source of revenue, to fund advertising and other marketing initiatives needed to sell insurance policies on behalf of the insurance company. The agency is paid only when policies are sold. However, the commissions paid are far in excess of the marketing costs that could be ascribed to the successful sale of those policies. In effect, the commissions reimburse the agency for all of its marketing and staff costs, not just those associated with issued policies. Therefore, economically speaking, the difference between the two models is “form over substance”. The current guidance for deferred acquisition costs under ASC 944-30 allows companies that use a direct-to-consumer marketing model to capitalize acquisition costs that may
not be eligible for capitalization under the proposed ASU. For example, many direct-to-consumer companies use television advertising that prompts people to respond by visiting the company’s website or calling a memorable phone number. Companies measure the response rates for their advertising by identifying the increase in website traffic or phone volume that occurs when the advertising is running. Thus, under existing guidance, companies can demonstrate the advertising costs vary with and are primarily related to acquisition of new policies. In contrast, in order to meet the requirements of ASC 340-20, companies may be required to set up special websites or special phone numbers which might decrease the effectiveness of the advertising simply in order to be able to demonstrate the linkage between advertising and new policies. For insurance companies using an agency system, capitalization would continue to be permitted for the same types of costs through the agency commission structure. In both distribution models, an insurance company spends money to acquire new customer relationships, and the costs are spent on both successful and unsuccessful efforts. Allowing an insurance company that uses an independent agency model to capitalize such costs while prohibiting insurance companies that use direct-to-consumer models from doing so would cause inconsistent treatment under GAAP between companies whose advertising and marketing costs have the same economic characteristics.

The discrepancy between economics and the proposed GAAP accounting is particularly pronounced under the direct-to-consumer distribution model. A key difference between the direct-to-consumer model and the independent agency model is that the agency is paid a commission on every policy renewal, while acquisition costs on policy renewals are minimal in the direct-to-consumer model. GAAP and economics are reasonably well aligned for an insurance company that sells its policies through independent agencies because their acquisition costs principally relate to the term of the policy, which is the same period over which GAAP deferred acquisition costs are amortized. In contrast, the acquisition costs for an insurance company that uses a direct-to-consumer model are economically associated with the lifetime of the customer relationship, which includes future policy renewals in addition to the initial policy term. This discrepancy between a direct-to-consumer insurance company’s economics and GAAP already exists, as acquisition costs cannot be capitalized for a period that is longer than the initial policy term. The proposed accounting would be even further from the economics for an insurance company that uses direct-to-consumer distribution model.

We also believe that the proposed changes will not be favorably viewed by investors and analysts. The proposed changes would impact the two most important financial metrics used in the property-casualty insurance industry: book value per share and the combined ratio. Given the reasons outlined above, we believe that investors and analysts that wish to compare direct-to-consumer insurance companies and agency insurance companies will attempt to adjust the published book value per share and combined ratios of the direct-to-consumer insurance companies by estimating what deferred acquisition costs would have been under current GAAP, most likely by using an assumed ratio of deferred acquisition costs to unearned premiums. Since this ratio can vary significantly over time, the comparability will be impacted unnecessarily by uncertainty and estimation error. We believe this would make the financial statements less comparable and therefore less useful.

We have been following the Board’s joint project with the IASB to create a new comprehensive basis of accounting for insurance contracts. We understand the Board’s desire to change the insurance accounting model to one that favors a balance sheet approach over a revenue/expense matching approach. We encourage the Board in its efforts, particularly with respect to incorporating time value-of-money and reserving uncertainty within insurance contract valuations, as these changes will more closely match GAAP accounting with the economics of the insurance business. In order to minimize implementation costs and reduce potential confusion for investors and analysts, we suggest that revisions to the accounting treatment for acquisition costs be developed as part of the comprehensive reconsideration of
Financial Accounting Standards Board
February 12, 2010

the accounting treatment for all components of insurance contracts under the joint project and implemented all at the same time.

Respectfully submitted,

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