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Thank you for the opportunity to comment on the Discussion Paper: Preliminary Views on Insurance Contracts. On behalf of the Statutory Accounting Principles (E) Working Group (SAPWG) of the National Association of Insurance Commissioners (NAIC), I am pleased to provide you with comments on the Discussion Paper.

Purpose for NAIC Comment
The Statutory Accounting Principles (E) Working Group (SAPWG) of the NAIC has the responsibility of developing and proposing new Statements of Statutory Accounting Principles (SSAPs) to be used by insurers in the United States. Statutory Accounting Principles (SAP) utilize a framework established by GAAP; therefore, the NAIC believes it is important to comment on GAAP exposure drafts that could materially affect SAP before such guidance is finalized. It should be noted the NAIC is expecting a policy decision by state insurance commissioners in 2011 which could result in a major modification to the current SAP framework. Although discussions regarding this policy decision are just beginning, the range of possible outcomes includes a continuum of options, including but not limited to replacement of SAP with US GAAP, International Financial Reporting Standards (IFRS), or these standards adjusted for prudential filters. Our comments consider the possibility of such a policy decision.

General Response
As noted within paragraph 5 of the Discussion Paper (DP), the FASB’s objective is to improve US GAAP for insurance contracts by developing high-quality guidance that addresses recognition, measurement, presentation and disclosure. Specifically, the project is intended to improve, simplify and achieve convergence of the financial reporting requirements for insurance contracts and to provide investors with decision-useful information. As a result of this stated FASB objective, US insurance regulators believe the issue identified in question 32 – the most appropriate improvement to U.S. GAAP – is the foremost issue that must be addressed.

US insurance regulators strongly prefer the continuation of a two-model approach whereby the accounting for short-term insurance contracts, defined by quadrant 1 of Table 1, is separate and distinct from all other insurance contracts. This preference is substantiated by the success of the two-model approach during recent and historical periods of economic stress. Although a revised version of the proposed building-blocks approach would likely be appropriate for long-term contracts, (quadrants 2, 3 & 4 in Table 1) utilizing the current “short-term” measurement model in place for short-term insurance contracts would provide reliable and decision-useful information about both pre-claim and post-claim liabilities of such contracts for investors and other financial statement users. It is our assessment that forcing similar measurement models for contracts with fundamental differences in their characteristics will likely result in a final model that is less useful than existing accounting standards, resulting in less understandable investor information.

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1 As illustrated in Table 1, US regulators are specifically referring to “short-term contracts” to represent insurance contracts with both short-term coverage periods and short-term claims paying periods.
There is often confusion distinguishing between “short-term” and “long-term” contracts, as coverage and claims durations can be different, and thus should not be used interchangeably. We offer the following chart to further illustrate the classifications at inception of short-term contracts and long-term contracts as referenced throughout this comment letter. Furthermore, we would welcome the opportunity to work further with the FASB on the exact definition of duration and short-term claims:

### TABLE 1

<table>
<thead>
<tr>
<th>Short-Term Coverage</th>
<th>Long-Term Coverage</th>
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</thead>
<tbody>
<tr>
<td><strong>Short-Term Claims Paying Period</strong></td>
<td><strong>Building-Block Approach, Includes Discounting</strong></td>
</tr>
<tr>
<td>UPR (Pre-Claims – No Discounting)</td>
<td><strong>Quadrant 2 = long-term contracts</strong></td>
</tr>
<tr>
<td>Claims Discounting Likely Immaterial (e.g., auto, homeowners)</td>
<td></td>
</tr>
<tr>
<td>References to “short-term contracts” within this comment letter is limited to contracts that fit within this specific category as they have both a short-term coverage period as well as a short-term claims paying period.</td>
<td>Quadrant 1 = short-term contracts</td>
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<tr>
<td></td>
<td><strong>Quadrant 3 = long-term contracts</strong></td>
</tr>
<tr>
<td><strong>Long-Term Claims Paying Period</strong></td>
<td></td>
</tr>
<tr>
<td>UPR (Pre-Claims – No Discounting) Or Building-Block Approach</td>
<td>UPR = Unearned Premium Reserve (Pre-Claims – No Discounting) – As noted in the chart above, US insurance regulators support a position in which application of the Unearned Premium Reserve is permitted, but not required, for short-term coverage contracts with long-term claims paying periods.</td>
</tr>
<tr>
<td>Discounting for Post-Claims If Material Effect (e.g., workers comp, general liability)</td>
<td></td>
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<tr>
<td></td>
<td><strong>Quadrant 4 = long-term contracts</strong></td>
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With the strong recommendation for separate measurement models for short-term contracts and long-term contracts it is our assessment that appropriate improvements would be achieved for long-term contracts by pursuing an approach based on the FASB’s preliminary views in the DP with some changes (choice d), and for short-term contracts by incorporating targeted revisions to the current US GAAP standard proven to be effective (choice e).

US insurance regulators highlight that continuation of the two-measurement model approach would support the FASB’s desired improvements noted in paragraph 7 of DP, and would continue with an approach that results in the most useful and understandable information for investors:

1. “Insurance entity orientation” – US insurance regulators agree that contracts that transfer significant insurance risk and “contain identical or similar economic characteristics” should be accounted for in a similar manner regardless of the type of entity issuing the contracts. US insurance regulators note that the economic characteristics can vary significantly between contracts. As such, requiring short-term contracts to follow a measurement model suitable for long-term contracts would not result in an improvement as the accounting requirements would be inconsistent with the economics of the business.

2. “Definition of an insurance contract” – With the exception of differentiating long-term contracts and short-term contracts, US insurance regulators generally agree with the proposed insurance definition in paragraph 22 of the DP, noting that “compensation” is a better term than “indemnification” in describing insurance contract benefits. Although these terms have broadly the same meaning, the term
indemnification is not generally applicable to life products and may be too limiting as this term implies a concept of “made whole,” whereas there are insurance products that may result in the policyholder or claimant being in an improved position after receiving the benefit from an insurance claim.

3. “Deferral of acquisition costs” – US insurance regulators agree that ASU 2010-26, Financial Services—Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (ASU 2010-26) has significantly improved the accounting for acquisition costs under insurance contracts, and is superior to the guidance proposed within the IASB ED. US insurance regulators have concerns that the proposed IASB approach does not effectively consider costs incurred by direct-marketing insurers, and failing to consider the approach of these insurers could have material financial impact, resulting in competitive disadvantages. Specifically, under the current IASB ED acquisition costs from a third-party distribution channel will be included in fulfillment cash flows, but in-house distribution channels would expense costs. Furthermore, US insurance regulators support the position within the FASB DP that acquisition costs shall be identified as part of the cash flows from a portfolio of insurance contracts. US regulators strongly believe that it is important for acquisition costs, as well as other facets considered in the measurement of insurance contracts, to be determined at the portfolio level and believe this is another element of how the FASB DP is superior to the IASB ED.

4. “Assumptions for traditional long-duration contracts” – US insurance regulators agree that assumptions of risks and uncertainties inherent in these contracts should be reevaluated and updated at each reporting period to reflect all available information. US insurance regulators note that this desired improvement would likely not be achieved under the IASB ED as that proposed standard provides for a residual margin to be determined at inception and not adjusted subsequently. US insurance regulators agree that any change in expected future cash flows as a result of changes in future non-financial assumptions should be recognized in any residual margin. Although we fundamentally disagree with the risk and residual approach, we have several concerns regarding the IASB ED proposal to lock-in the residual margin if it is incorporated, which includes:

- By locking in the profit, the future revenue and expenses from the provision of services in the future is effectively locked in, contrary to the reality that future services are likely to be more or less profitable as future assumptions vary.

- Allowing any changes in future non-financial assumptions or risk margin to go straight to profit and loss will produce volatility in reported profit for only a small change in assumptions, particularly for life insurance where the impact over a number of years is capitalized.

- Booking any change in future non-financial assumptions or risk margin directly into profit and loss leaves the system open to manipulation – assumptions will be set adversely at inception and then subsequently improved, generating a capitalized profit. Even a small change in assumptions for long-term insurance can have significant effects. In contract, the FASB DP proposal limits the risk of manipulation, since any change in non-financial assumptions will not have an immediate effect on profit.

5. “Discount rate for traditional long-duration contracts” – US insurance regulators agree that the discount rate, when used, should reflect the characteristics of the insurance contract liability, i.e., the economics of the insurance obligations in the jurisdiction including the nature, structure and term.

6. “Lack of discounting of liabilities for short-duration contracts” – Claims for short-duration contracts tend to be settled quickly. The current US GAAP model for short-duration contracts does not require discounting and this is appropriate given the general immaterial nature of any discounting effect. Although US insurance regulators agree with the concept of time value of money, the “if material” qualification is necessary to achieve improvements under existing US GAAP. In preliminary calculations, the discounting of short-duration contracts has been identified as material only in periods of significantly
high interest-rates. US insurance regulators have significant concerns with the proposed premium-allocation approach (PAA) method within the IASB Exposure Draft (ED) as the concept of materiality seems to be excluded from determining applicability for the discounting requirements within that approach.

Responses to Specific Issues:

Definition and Scope

Definition and Scope: As previously noted, with the exception of differentiating long-term contracts and short-term contracts, US insurance regulators generally agree with the proposed insurance definition in paragraph 22 of the DP. We do believe further clarity on scope exclusions could be included, particularly with regards to the treatment of manufacturer warranties underwritten by an insurer. As detailed in the IASB ED and paragraph 28a of the FASB DP, product warranties issued by a manufacturer, dealer or retailer are excluded, thus it seems that such products written by insurers would be within scope.

Financial Instruments with Discretionary Participation Features: US insurance regulators agree with the IASB on the inclusion of discretionary participation features in the scope of the insurance contracts standard if such contracts share in the performance of the same pool of assets as participating insurance contracts. Although we understand the rationale for the proposed FASB exclusion, we believe the IASB position is more likely to have similar products accounted for in a similar way as these contracts share features more similar to insurance contracts. US insurance regulators believe that exclusion of such contracts would be contradictory to the desired FASB improvement for similar contracts to be accounted for in a similar manner.

Unbundling: US insurance regulators believe clarification of the unbundling requirements is necessary for consistency. US insurance regulators particularly note that the reference in paragraph 40c of the FASB DP refers to goods and services that “are not closely related to the insurance coverage.” and are uncertain if that criteria is intended to be different from what is included in ASC 815-15-25-1a with regards to “not clearly and closely related to the economic characteristics and risks of the host contract.” Additionally, if unbundling requirements that mirror the proposed IASB ED are adopted for US GAAP, US insurance regulators request further clarification on how the revisions might result in different unbundling requirements in comparison to the existing guidance within the FASB Codification.

Recognition and Measurement

Fulfillment Cash Flows: US insurance regulators support the premise for measuring insurance contracts based on the concept of probability-weighted cash flows to fulfill insurance contract obligations. We agree that insurers should measure liabilities using cash flows that will arise through fulfillment because this reflects how the insurer expects to extinguish the liability – by fulfilling the liability through payment of benefits and claims to policyholders as they become due. We strongly support the guidance included in paragraphs BC50a and BC51 of the IASB Exposure Draft (ED) that prohibits the reflection of non-performance risk by the insurer in the measurement of the insurance contract liabilities. Due to the nature of insurance contracts, we agree it is inappropriate to allow a reduction of liability on the basis of an insurer’s own-credit standing. Although US insurance regulators support the overall premise, we offer the following comments on application:

- US insurance regulators identify that paragraph 17 of the IASB ED is drafted as if initial measurement is to occur at the individual insurance contract level, but this premise does not seem to be supported by the remainder of the IASB ED. Particularly, it is noted that paragraphs 23 and 26 of the IASB ED indicate that the probability-weighted expected future cash flows and the risk adjustment are to be measured at the portfolio level. US insurance regulators believe the adopted insurance contracts standard should unambiguously require measurement of portfolios of insurance contracts, rather than measurement at the individual contract level. Insurance contracts are managed at the portfolio level and economic decisions are made at this level, rather than for each individual contract.
• US insurance regulators are concerned with the potential misinterpretation regarding the terminology “unbiased probability weighted cash flows” as it is included in appendix B, paragraphs 38-41 of the IASB ED. For example, paragraph B39 highlights that it is not always necessary to develop explicit scenarios, but this paragraph also suggests that stochastic modelling may be necessary where complex cash-flows exist. Many would suggest that much of life insurance involves complex cash flows, but stochastic modelling is currently used to value mainly the most complex products. Smaller insurers could especially benefit from a greater focus of the application guidance on the reasonable use of proxy methodologies. Additionally, for short-term we have even greater concern regarding paragraphs B39-41 which relates to the historic difficulty to predict jury and judicial decisions, future economic changes, future societal changes, etc. Ultimately, our point is that determining a statistical mean estimate of outcomes does not require identification of the full range of possible scenarios and should include appropriate management judgment.

• US insurance regulators identify that the current proposal for “fulfilment cash flows” currently excludes certain cash flows that are relevant to the fulfilment of an insurance contract. Insurers will continue to look to include the full cost of fulfilling their insurance obligations, including general overheads which exist as the result of insurance business but do not vary in proportion to the volume of contracts, into the premiums charged to policyholders. To the extent that such premiums adequately consider the full costs of fulfilment, the initial liability would not be understated under the composite approach, but the earnings emergence may not best reflect the pattern of future fulfilment expenditures that have been priced into the premiums. To the extent that policy premiums have not been set to adequately consider the full cost of insurance contract fulfilment, the initial liability would be understated, with this effective ‘premium deficiency’ not captured as a loss until those future fulfilment expenditures actually occur.

Contract Boundary: US insurance regulators, from a regulatory perspective, are concerned with the definition of contract boundaries in paragraph 27 of the IASB ED. It is our assessment that the proposed language appears to treat many insurance (e.g., health) contracts as extending beyond the next policy anniversary date due to the fact that some individual contracts cannot be re-rated commensurate with their risk in light of regulatory restrictions, even though it may be possible for the portfolio of contracts as a whole to be re-rated commensurate with its risk. We support revised language (27b) defining the boundary of an insurance contract as follows:

27. The boundary of an insurance contract distinguishes the future cash flows that relate to the existing insurance contract from those that relate to future insurance contracts. The boundary of an insurance contract is the point at which an insurer either:

a. is no longer required to provide coverage, or

b. has the right or the practical ability to reassess the risk of the particular policyholder and, as a result, can set a price for that contract that either (1) fully reflects the risk of the particular policyholder; or (2) may not fully reflect the risk of each particular policyholder in light of regulatory restrictions but can, in conjunction with prices set for other contracts in the same portfolio within the same portfolio and with similar dates of inception, fully reflect the risk of that portfolio. In assessing whether it can set a price that fully reflects the risk, an insurer shall ignore restrictions that have no commercial substance (i.e., no discernible effect on the economics of the contract).

US insurance regulators also identify that the proposed FASB DP change to recognize risks at the earlier of the date they are bound or the date the insurer is first exposed to risk will require extensive system modifications that will be quite costly for insurers. We do not believe that such extensive system modifications are justified simply to address the narrow issue of identifying an onerous contract – particularly as few onerous contracts are knowingly and deliberately written at inception.

2 A price fully reflects the risk if it is adequate on its own to cover the risks for the particular contract year in question and does not rely on sufficiencies of prices from other contract years.
Risk Adjustment/Composite Margin: US insurance regulators have a similar view to that of the FASB in supporting a single margin calibrated to premium, resulting in no gain at initial measurement. Nonetheless, US insurance regulators would term such a margin as a risk margin calibrated to premium at initial recognition. US insurance regulators strongly believe there is an inability to reliably calculate and separate margin into “risk” and “residual” components. US insurance regulators note that the IASB has previously indicated that (1) there is no active secondary market for insurance contracts, thus there is generally little market information on the price of risk; and (2) even with the provisions to refine the determination of a risk adjustment, it is expected that there will be continued divergence in practice if the risk adjustment is not initially calibrated to premium. However, we recognize that similar products can have materially different premiums in some cases, which would thereby result in different margins. US insurance regulators believe a process that provides for a risk adjustment, not calibrated to observed premium, is subject to uncertainty and potential manipulation and leads to the conclusion that the resulting residual margin – as it is calculated from the established risk adjustment – must also be considered inherently uncertain and likely not representative of the “expected profit” from the insurance contract. US insurance regulators agree with the alternative view of Mr. Engström and Mr. Smith in the IASB ED, as they believe it is not possible to objectively compute a risk assessment, and strongly support their conclusion that “the risk adjustment and the residual margin can vary significantly by insurer for the same risk, thereby producing different results in financial statements. Indeed at one end of the spectrum an insurer could set the quantity and price of risk to eliminate any residual margin.” US insurance regulators agree that a difficult issue arises when the premium is close to the expected present value of cash flows and therefore the composite margin is slim. For regulatory purposes, a required minimum margin by line of business may be necessary, although we understand that this approach may not be particularly palatable to accounting standard setters. Although onerous contracts and portfolios have also been identified as concerning, US insurance regulators note that human behavior is such that few onerous contracts are knowingly and deliberately written at inception – which is not to say that all insurance contracts are profitable; many are written in the expectation of a profit only for the insurer to discover later that they are loss-making and should have been measured with hindsight as onerous at inception.

IASB Risk Adjustment Calculation: As stated above, US insurance regulators do not support separate determinations of risk and residual margins due to the inherent uncertainty, potential manipulation, and comparability concerns that result. However, if such an approach is incorporated into a global standard, US insurance regulators further identify that the objective for the IASB risk adjustment noted in paragraph 66 of the DP (also in paragraph 35 of the IASB ED) does not fit with an approach based on fulfillment cash flows, but rather is more reflective of a current exit value approach. Additionally, US insurance regulators are concerned with the limitation of techniques in the IASB ED for determining risk adjustments. Such limitation does not allow for the development of new actuarial techniques, and the three techniques identified may not be as cost-effective as other techniques in certain situations. For example, some companies currently use Economic Cost of Ruin as a measure of risk. US insurance regulators identify that the limitation of techniques results from a desire to obtain comparability among financial reports of insurers. However, even if the techniques are limited, comparability will likely not be achieved. Different insurers will have different conclusions as to the most appropriate technique based on their circumstances, therefore eliminating any presumption of comparability even among insurers with similar products.

Discounting – Long-Term Contracts: US insurance regulators agree that the discount rate for long-term contracts should reflect the characteristics of the insurance contract liability. US insurance regulators are aware that the preferred method to calculate the discount-rate has resulted in significant world-wide debate and support a converged solution. The details of such a converged solution are unclear at present, and US insurance regulators will be supporting a call for the IASB and the FASB to create a working group on the issues surrounding discount rates in which we would wish to participate. Pending the report of such a group, US insurance regulators are prepared to consider the possibility of either the same discount rate in the balance sheet and the income statement, or a different rate in each with the difference between the two being recorded in Other Comprehensive Income. As a single rate, or for income statement presentation, at present, the majority of US insurance regulators are considering a discount rate approach that reflects the economic default adjusted rate (EDAR). Under this approach, insurance liabilities would be discounted at an average asset book yield less a prescribed provision for defaults (the risk adjustment). This provision is most impacted by real-world historical distributions of default
losses, but also contains a limited recognition of the current market view of risk through two elements that rely on current market spreads. As such, the default spread will not necessarily move directly with changes in market interest rates, but will be heavily informed by them. If the balance sheet were to be valued differently, then US insurance regulators are considering the possibility that guidance be prescribed that directs companies to value liabilities in the balance sheet using the same discount rate as required in the IASB standard, IAS 19, which is a high-quality corporate bond rate – interpreted to be a AA rate in the US. Under such circumstances that difference between the high-quality corporate bond rate and EDAR would go through other comprehensive income. Pending FASB/IASB work on financial instruments, we are concerned that liabilities and supporting assets will be valued using different methods which can distort financial results and conditions. An inappropriate discount rate can aggravate such distortions. In addition, either risk margins or discount rates should include provision for expected default cost (e.g., fund the allowance account in the IASB’s Financial Instrument proposal).

Discounting – Short-Term Contracts: As previously stated, the timeliness of claim settlement for short-term contracts would generally result with the discounting of claim liabilities having an immaterial effect. Due to the immaterial nature of discounting in short-term contracts, US insurance regulators believe continuation of the existing measurement model (Unearned Premium Reserve), which does not require discounting in the pre-claims or post-claims period, would result with the approach that provides the most transparent information to investors. To address FASB concerns for consideration of time value of money in situations that would have a material effect, US insurance regulators recommend a presumption of immateriality in (1) short-term contracts with a coverage period/contract boundary that extends for one year or less - except in periods in which the current interest rate and the outlook for interest rate would result in a material impact and (2) short-term contracts that extend for more than one-year and use of the unearned premium reserve would not result in materially different results from the present value of the fulfillment cast flows. As noted previously, US insurance regulators would welcome the opportunity to work further with the FASB on the exact definition of duration and short-term claims.

Acquisition Costs: US insurance regulators agree with the consideration of incremental acquisition costs, defined in ASU 2010-26, as cash flows related to the insurance contract. As previously stated, US insurance regulators agree that ASU 2010-26, Financial Services—Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (ASU 2010-26) has significantly improved the accounting for acquisition costs under insurance contracts, and is superior to the guidance proposed within the IASB ED.

Earnings Recognition: US insurance regulators agree with recognizing the composite margin over both the coverage and claims handling periods. This is considered appropriate as profit will not be fully recognized until de-recognition of liabilities is complete and no remaining uncertainty exists. US insurance regulators have significant concerns with the IASB ED approach that allows the “residual” margin to be recognized into profit over the coverage period, with the “risk” margin recognized over the claims-paying period. As it is has already been identified that the risk margin is inherently uncertain, US insurance regulators fear that the recognition of the equally uncertain “profit” (residual margin) before de-recognition of all liabilities could result in misleading financial presentations. Nonetheless, US insurance regulators have significant concern over an apparent FASB Staff interpretation of the FASB DP provided at the Insurance Working Group regarding the use of unearned premium when the entire margin (whether referred to as a risk or composite) would be released to income over the coverage period. Our concern is with quadrant 3 items (short-duration coverage period with long-duration claims paying periods) where under this apparent interpretation only the first two building-blocks would exist at the end of the coverage period – i.e., discounted cash flows without any additional margin for uncertainty. Such interpretation appears inconsistent with paragraph 82 of the DP which indicates that “the composite margin would be recognized in earnings over the coverage and claims handling periods to reflect the insurers exposure to uncertainties related to the amount and timing of net cash flows.”

IASB Premium Allocation Approach: As previously stated, US insurance regulators strongly prefer a two-model approach whereby long-term contract accounting is separate and distinct from short-term contracts. US insurance regulators stress that this preference is not accomplished by the premium allocation approach contained within the IASB ED. The IASB ED premium allocation approach is meant to be a simplified approximation of the full building-blocks model for the pre-claims liabilities of some short-term contracts. However, this approach represents a significant departure from an Unearned Premium Reserve approach in that it adds significant
complexity with no compensating benefits. Key differences between the Premium Allocation Approach and the Unearned Premium Reserve approach include the requirement to discount premiums expected to be received in approximately twelve months or less, an unnecessarily complex balance sheet presentation, and a requirement to continuously compute the fulfillment cash flows, which includes an explicit risk adjustment, for purposes of supporting the adequacy of the reporting liability. As such, the basic requirements of the Premium Allocation Approach eliminate any “simplification” benefits of the approach.

**Reinsurance**

Treatment of Reinsurance: US insurance regulators believe the discussion of ceded reinsurance within both the IASB ED and the FASB DP is unclear. It appears that the proposed guidance would not provide consistent measurements in situations where the direct contracts being reinsured are measured using the premium allocation approach and the reinsurance contract is measured using the present value of fulfillment cash flows. It is also noted that the proposed guidance does not seem to consider various reinsurance agreements in which the reinsurance agreement covers contracts not yet written or recognized by the ceding company. US insurance regulators identify that some reinsurance contracts cover policies attaching during a 12-month period, not the underlying covered exposure during a 12-month period. These ceded contracts have up to a 24-month coverage period, and as such, the ceded contract would not be viewed as “short-term” and would be under a different accounting basis than the underlying direct contracts for pre-claims liabilities. It is the US insurance regulator recommendation that the guidance be revised to clarify that the reinsurance measurement should follow the measurement method used for the underlying direct insurance contract.

**Presentation and Disclosure**

Margin Presentation Approach: US insurance regulators are concerned with the proposals in the IASB ED and the FASB DP to incorporate a margin presentation approach for both long-term contracts and short-term insurance contracts. As identified by the IASB in the basis of conclusions, the information presented under a premium approach – premiums reflecting revenue – and the information this approach provides – premiums over a coverage period – is a key performance measure for an insurer. US insurance regulators completely agree with this assessment. It is our opinion that excluding premiums, claims expenses, claims handling expenses, incremental acquisition costs, and other expenses included in the measurement of insurance contracts from the statement of income will significantly impair the usefulness of this statement for all financial statement users. Although both the IASB and FASB have identified that information regarding premiums and expenses is relevant, and therefore should be disclosed, it is a long-standing position that disclosure within the financial statements is not an adequate substitute for reporting on the face of the financial statements. US insurance regulators believe that the summarized margin approach is, at best, a proxy for actual revenue and cash flows. Therefore, we recommend that the margin approach be reflected in the notes to the financial statements, rather than on the face of the financial statement. US insurance regulators were especially surprised on the IASB decision to require the summarized margin approach when the IASB has identified that the building blocks, particularly the determination of the risk and residual margins (and subsequent changes in such) will likely have continued divergence in application and be subject to arbitrary assessment. It is the position of US insurance regulators that in order to provide information that enables users to complete comparisons and financial assessments on insurers, the statement of income should provide actual, relevant information regarding premiums and expenses. In addition to concerns with the presentation on the statement of income, US regulators also have concerns with the presentation requirements for the statement of financial position, noting that the reporting of either a net asset or net liability for each insurance portfolio will not provide useful information on the face of the financial statements. Financial statement users would benefit from separate reporting of unearned premium reserves and claims reserves as well as uncollected premium balances. There generally would not be a right to offset between assets receivable from one policyholder with a claim obligation owed to or on behalf of another policyholder. As loss reserves and unearned premium reserves convey important information to users, a net presentation of such items would result in a significant reduction of decision-useful information on the face of the balance sheet. US insurance regulators highlight that this concern applies to all forms of insurance contracts, but stress that there is significant trepidation for short-term insurance contracts.
Dual Presentation Proposal: US insurance regulators are also significantly troubled with the FASB DP proposal to incorporate separate presentation approaches for insurance contracts measured under the building-block approach (margin presentation) and those measured under a modified approach (premium presentation). We believe the FASB concern identified in paragraph 125 about the use of two different presentation approaches for insurance contracts is appropriate as it will likely result in significant confusion and misinterpretation of financial statements throughout the entire user community. As previously stated, US insurance regulators strongly support two separate measurement approaches for long-term contracts and short-term contracts, with short-term contracts following an approach similar to that utilized within current US GAAP and in other parts of the world. If such an approach is retained, US insurance regulators would be more attuned to separate presentation approaches – assuming that both approaches provide information necessary to complete comparisons and assessments of insurers. However, if a single-measurement model is proposed – as it is in the FASB DP and the IASB ED – separate presentation approaches will further expand the confusion regarding the proposed modified approach, particularly when short-term contracts move from a pre-claims liability (premium allocation approach) to the post-claims liability (building-block approach) and how such contracts should be presented.

Disclosure: US insurance regulators do not disagree with the overall disclosure principle provided in paragraph 79 of the IASB ED: “To help users of financial statements understand the amount, timing and uncertainty of future cash flows arising from insurance contracts, an insurer shall disclose qualitative and quantitative information about (a) the amounts recognized in the financial statements arising from insurance contracts; and (b) the nature and extent of risks arising from insurance contracts.” Although US insurance regulators do not disagree with the overall IASB ED disclosure principle, there is significant concern with the specific, voluminous disclosures considered necessary – presented in paragraphs 85-97 (six pages) of the IASB ED – to achieve compliance with the disclosure principle. It seems that compliance with these extensive disclosure requirements will be costly, and likely provide only limited benefit to users. US insurance regulators are also particularly concerned regarding the extent of proprietary information that the IASB ED seems to require within the disclosures. For example, with regards to the risks arising from insurance contracts other than insurance risks, the guidelines in the ED specifically indicate that the disclosure of summary qualitative information regarding exposure to risk shall be based on information provided internally to key management personnel of the insurer and provide information about the risk management techniques and methodologies applied by the insurer. It is our assessment that these requirements may be crossing the line between pertinent information necessary to assess the insurer and confidential information regarding the insurer’s operating assessments. Lastly, as previously stated, US insurance regulators are concerned with the overall presentation of information in the statement of income for insurance contracts. It is likely that the determination of essential disclosures may be significantly impacted if the statement of income provides the information necessary to allow users to complete comparisons and financial assessments on insurers. US insurance regulators recommend that the IASB and FASB establish a technical advisory group to consider the appropriate performance metrics for insurers and then conclude on the appropriate presentation and disclosure requirements that effectively presents performance.

Transition and Effective Date: Although not specifically addressed within the FASB DP, US insurance regulators are concerned with the proposed transition and effective date guidance within the IASB ED. If the separate component (risk and residual) proposal is adopted by the IASB, our concern involves the exclusion of any residual margin from the measurement of each insurance contract portfolio at transition and then subsequently. Under this approach, insurers would effectively recognize all remaining “profit” in existing insurance contracts into equity at the time of transition. This process would force an overstatement of equity at the time of transition to the new standard, and offset this overstatement with understatements of earnings for several decades following the transition. US insurance regulators believe that if insurers have the ability to go back and calculate the building blocks accurately then they should be allowed to do so. The next best option would be to look for a suitable proxy for the calculation with full disclosure of the methodology used, such as treating the transition like a business acquisition. If none of this is possible then the original IASB staff proposal set out in paragraph BC 249 in the Basis of Conclusions would be more appropriate than the Board’s proposal. In addition, US insurance regulators believe that other aspects of the transition guidance need clarification, such as reinsurance.
We appreciate the opportunity to comment on the 2010 Discussion Paper, *Preliminary Views on Insurance Contracts*. Should you have any questions, please contact me at 212-480-2299, or the following NAIC staff: Rob Esson 816-783-8131, Julie Gann 816-783-8966, Robin Marcotte 816-783-8124 or John Tittle 816-783-8120. As a reminder, I am planning to participate in the Dec. 20, 2010 FASB roundtable discussion as the representative from the National Association of Insurance Commissioners (NAIC). Mr. Esson will also be participating as the representative from the International Association of Insurance Supervisors (IAIS).

Sincerely,

Joseph Fritsch
Chair, NAIC Statutory Accounting Principles Working Group
New York State Insurance Department - Director of Insurance Accounting Policy