December 15, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Discussion Paper – Preliminary Views on Insurance Contracts (File Reference No. 1870-100)

American Financial Group, Inc. (“AFG”) appreciates the opportunity to comment on the FASB’s Discussion Paper – Preliminary Views on Insurance Contracts (“DP”). AFG is traded on the New York Stock Exchange (NYSE: AFG) and has assets in excess of $30 billion. We are engaged primarily in property and casualty insurance, focusing on specialized commercial products for businesses, and in the sale of traditional fixed and indexed annuities and a variety of supplemental insurance products such as Medicare supplement. We support the FASB’s and IASB’s overall objective of convergence and migration to high quality global accounting standards, including comprehensive insurance standards. We believe, however, that the standards should be reflective of differing types of insurance.

General

We believe that current U.S. GAAP adequately addresses the accounting for insurance contracts in a manner that produces relevant and reliable results that are understood by investors and consistent with the way insurance businesses are managed and evaluated. In anticipation of preparing this response, we reached out to several users of our financial statements to see if they had concerns with the accounting and reporting of insurance contracts under current GAAP. In addition, we asked for their thoughts on the accounting models proposed in the IASB Exposure Draft and FASB DP. Although few professed significant knowledge of the proposed accounting, none expressed any significant concerns with the current GAAP accounting for insurance contracts. We are also aware that the insurance industry regulators, the National Association of Insurance Commissioners, are generally satisfied with existing U.S. GAAP. If this input is consistent with the general views of investors and other users of the financial
statements, it presents a strong argument against the complete overhaul of insurance accounting described in the DP. We strongly recommend that the Board reach out to the user communities to ensure that they are aware of the proposed changes and to solicit their input. It is important for the Board to fully understand the perceived need for these changes so as to be certain that the costs of such changes do not exceed the benefits.

Notwithstanding, we understand the need for the International Accounting Standards Board to develop a comprehensive insurance accounting standard for companies reporting under International Financial Reporting Standards ("IFRS"). Accordingly, we believe that the FASB should consider targeted enhancements to existing U.S. GAAP and advocate for an IFRS model similar to current U.S. GAAP to mitigate the differences with the IFRS Standard rather than developing an entirely new standard.

Further, we believe that the accounting for insurance contracts should be reflective of the way in which the insurer prices, fulfills, manages and evaluates its insurance contracts. While we understand that a comprehensive model to cover all insurance contracts may be desirable, in reality there are substantial differences in the insurance coverage and economics between long-duration life-type products (including annuities) and shorter duration property and casualty and health products that warrant separate accounting models. The profitability of life-type products is generally driven by the ability of the insurer to earn investment returns in excess of the amounts credited to policyholders ("spread"). In contrast, the profitability of property and casualty products (and other short-duration health products) is driven by underwriting results as measured by subtracting underwriting, loss and loss adjustment expenses from premiums, with investment returns as a secondary and distinct source of income.

**Probability-weighted Expected Cash Flows**

In reading through the DP, it appears that the IASB and the FASB have focused on life-type long-duration contracts where, due to the existence of large numbers of similar contracts and specific contract terms, the timing and amount of cash flows can be reasonably estimated (and currently is estimated) using stochastic modeling. In contrast, the insurance risks covered in many property and casualty and short-duration health-related contracts do not lend themselves to stochastic modeling as evidenced by the fact that the widely accepted property and casualty and health actuarial models currently used by the industry are deterministic rather than stochastic. As currently defined in the DP, calculating unbiased probability-weighted cash flows seems to require the use of stochastic modeling for property and casualty products where such modeling is not critical to how the business is managed and is not supported by existing actuarial models. Due to the degree of uncertainty as to the timing and amount of cash flows from property and casualty contracts, the guidance should allow the continued use of "management’s best estimate" (as supported by current actuarial techniques) as a proxy for probability-weighted cash flows in the determination of property and casualty insurance reserves.
It should also be noted that adding mathematical complexity to the calculation of insurance reserves implies a sense of consistency across entities that it may not actually deliver. While the mathematical computations may be consistent across entities, the results of those calculations would vary significantly as the assumptions driving the expected cash flows and the probability weights assigned to those cash flows would require judgment and therefore cannot be entirely unbiased.

**Discount Rate**

Although we believe that current U.S. GAAP is generally adequate for all insurance contracts, if the Board pursues an accounting model based on discounting cash flows, such model should be consistent with the way the business is managed and provide decision-useful information to users of the financial statements. As currently defined, discounting based on the current risk-free yield curve adjusted for illiquidity would not produce results that are consistent with the way most long-duration contracts are managed.

Because there is not an observable market for insurance liabilities, the liquidity premium is necessarily subjective and will likely be calculated differently at each entity. As a result, the discount rates used would not be consistent across entities resulting in less comparability and less meaningful information to investors.

For long-duration contracts like annuities, profitability is driven by the insurer’s ability to earn investment returns in excess of amounts credited to policyholders over the life of the contract. Accordingly, there is a critical link between the insurance liabilities and the assets that support those liabilities. Discounting insurance reserves based on the current risk-free yield curve (adjusted for illiquidity) rather than a rate based on expected long-term investment returns generally produces results that are not indicative of the actual performance of the contracts as it mismatches the effect of the time value of money on the liabilities as compared to the assets supporting those liabilities. This mismatch magnifies the accounting volatility caused by discounted cash flow-based accounting because the carrying value of assets and liabilities do not move in unison, despite being economically well matched. For long-duration contracts, the Board should consider allowing a discount rate based on the insurer’s expected investment returns to produce results that most appropriately match the actual performance of the contracts. Alternatively, the Board should consider allowing a discount rate based on the yield curve for a “typical” insurer investment such as a “AA” rated corporate bond to enhance comparability across entities. While this does not fully resolve the mismatch issue, it would still introduce investment return bases discounting.

In addition, using a yield curve as of a single point in time would result in the recognition of the impact of short-term movements in interest rates despite the long-term nature of the liabilities. The immediate recognition of these potentially temporary changes in interest rates would result in accounting volatility that may not be an accurate representation of the performance of the
contracts. If discounting based on a current yield curve is maintained, the Board should consider requiring/allowing the use of discount rates that reflect the impact of changes in interest rates over a longer period of time (i.e. using an "average" yield curve of the trailing 36 months) to better reflect the long-term nature of the liabilities.

Presentation

The DP contemplates requiring all insurance contracts to be presented in the Statement of Earnings on a margin basis (net basis), which highlights only the change in the insurance liabilities. This is inconsistent with the way in which property and casualty and other short-duration products are managed and evaluated. Presenting such contracts in the Statement of Earnings with no indication of premium or claim volume would not convey adequate information to users of the financial statements. For example, the margin-based insurance expense shown on the face of the Statement of Earnings would not tie to universally accepted key performance measures such as the combined ratio and the net insurance liability shown on the Balance Sheet would not tie to information presented in loss development tables. In addition, we believe that presenting premiums receivable, deferred acquisition costs, unearned premiums and loss reserves on a gross basis rather than on a net basis (as contemplated in the DP) conveys important information to users of the financial statements. Allowing insurers to present the key performance drivers on the face of the financial statements would provide decision useful information and reduce the use of supplemental non-GAAP measures. Relegating key performance drivers to footnote disclosure would force greater reliance on the footnotes than the financial statements themselves. Essentially, there is high probability that the footnotes will become the de facto primary statements as they will contain the information that drives investment decisions.

Summary

Our position on the Discussion Paper is summarized by the following points:

- We fully support the goal of having comprehensive global accounting standards for insurance contracts, as long as the standards are reflective of the different types of insurance contracts. High quality accounting standards should not be sacrificed to achieve a global standard.
- We believe the current U.S. GAAP accounting model is robust, time-tested (including during the recent financial crisis), produces relevant and reliable results that are understood by investors, and reflects the way insurers price, manage and evaluate contracts.
- The differences between short- and long-duration contracts are significant and warrant separate accounting models.
- Current guidance based on management's best estimate provides information to investors that is more transparent and no less reliable than probability-weighted expected cash flows.
• Discounting based on the risk free rate plus a liquidity premium is subjective and would not produce comparable results.
• Discount rates for long-duration contracts should be aligned with investment portfolio rates supporting the liabilities.
• Targeted improvements to U.S. GAAP would provide better quality financial statements than the model proposed by the IASB as contemplated in the DP.
• If significant changes to U.S. GAAP are adopted, there should be enough lead time to enable insurers to make needed software modifications and other process conversions to implement the new rules.

We have provided greater detail of the above concerns in our responses to the questions outlined in the FASB DP in the attached Appendix. We would be happy to discuss our comments in more detail with the Board. Please contact me at (313) 579-6633 if you have any questions regarding this comment letter.

Sincerely,

[Signature]
Keith A. Jensen
Senior Vice President
American Financial Group, Inc.
Appendix – Responses to specific DP Questions

Definition and Scope

1. Are the proposed definitions of insurance contract and insurance risk (including the related guidance) understandable and operational?

The proposed definitions of insurance contracts and insurance risk are understandable and operational.

2. If the scope of the proposed guidance on insurance contracts is based on the definition of an insurance contract rather than on the type of entity issuing the contract, would financial reporting be improved?

Yes, financial reporting across entities would be improved by defining insurance contracts based on the contract terms rather the type of entity issuing the contract. However, as discussed in our answer to DP Questions 7 & 18, we do not believe that a single model can be developed for both short-duration and long-duration products that is consistent with the significantly different ways in which such products are managed and evaluated.

3. Do you agree with the proposed scope exclusions? Why or why not?

We generally agree with the scope exclusions.

4. Should benefits that an employer provides to its employees that otherwise meet the definition of an insurance contract be within the scope of the proposed guidance? Why or why not?

We believe that employer-provided benefits should not be included within the scope of this guidance due to their unique attributes.

5. The Board’s preliminary view is that participating investment contracts should not be accounted for within the proposed model for insurance contracts but, rather, should be included in the scope of the proposed model for accounting for financial instruments. Do you agree? Why or why not?

We agree that participating investment contracts that do not meet the definition of an insurance contract should be added as a scope exclusion under paragraph 28 in the proposed model.

6. Do you support the approach for determining when noninsurance components of contracts should be unbundled? Why or why not?

The unbundling requirements in the DP are difficult to interpret, and therefore unclear. While we support the general concept of unbundling (bifurcating) components of insurance contracts
that are not clearly and closely related to the insurance coverage such as embedded derivatives and goods and services features, we believe that the proposal is unclear as to whether or not the deposit component of certain life insurance contracts, including fixed annuities, would be required to be unbundled and accounted for as a financial instrument. The DP could be interpreted to require the unbundling for annuities because account balances are credited with an explicit return based on a general account pool of investments. However, the DP criteria that “all” investment performance is passed to the policyholder, is generally not met for these contracts. We believe that account balance is integral to the measurement of most insurance contracts. Unbundling the deposit portion would complicate the measurement of such liabilities without much benefit to financial statement readers. If unbundling is maintained, we believe that the current examples in the DP should be modified to establish clear guidance as to when unbundling is required.

Recognition and Measurement

7. Do you agree with the use of the probability-weighted estimate of net cash flows to measure insurance contracts? Does that approach faithfully represent the economics of insurance contracts? Is it an improvement over existing U.S. GAAP?

For short-duration products, we do not agree with the use of probability-weighted cash flows. We believe that the current U.S. GAAP model is robust and adequately addresses the accounting for insurance contracts in a manner that produces relevant and reliable results that are understood by investors and consistent with the way insurance businesses are managed and evaluated. Since management is able to reasonably (but not precisely) estimate claim costs within a relatively short amount of time, we believe that adding complex mathematical models to produce financial statements will not be cost effective nor result in more accurate financial results. Accordingly, for these contracts, we do not believe the use of probability-weighted cash flows is an improvement over existing U.S. GAAP. Due to the degree of uncertainty as to the timing and amount of cash flows from property and casualty contracts, the guidance should allow the continued use of “management’s best estimate” (as supported by current actuarial techniques) as a proxy for probability-weighted cash flows in the determination of property and casualty insurance reserves.

For most long-duration products, we believe the use of net cash flows is an appropriate measurement principle and represents the economics of the products. However, we believe that the use of probability-weighted cash flows would be very subjective and judgmental and applied in various ways by different companies. This would not lead to the comparability the Board is seeking among similar companies. Alternatively, the standard should set forth the basic principles by which cash flows should be derived and allow companies to apply those principles as appropriate for its portfolio of products and the complexity of those products in a manner consistent with how the business is managed and evaluated. Many times a relatively simple model may provide a reasonable valuation, while complex products may require more modeling scenarios to arrive at a liability measurement. Overall we feel that current U.S. GAAP could be improved by shifting the accounting for all long-duration contracts (including life and long-term care insurance) to a model that incorporates net cash flows.
8. Do you think that an entity’s estimate of the net cash flows should include a risk adjustment margin?

We believe that current GAAP accounting for insurance contracts is adequate. However, if the building block approach is pursued, we would support the use of a composite margin over the calculation and maintenance of two separate margins. See response to DP Questions 9 and 15.

9. Is the objective of the risk adjustment margin understandable? If so, do you think that the techniques for estimating the risk adjustment margin (see paragraph 52(b)), faithfully represent the maximum amount that the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected?

While we do understand the concept of the risk adjustment margin, we do not believe that adding a risk adjustment margin will enhance financial reporting. Due to the lack of an observable market for insurance liabilities, the margin is necessarily subjective and is likely to vary widely in application by company. In addition, it will not be understandable to financial statement users.

10. Do you think that the risk adjustment margin would be comparable for entities that are exposed to similar risks?

See Question 9.

11. Do you agree with the description of cash flows that should be included in the measurement of an insurance contract? Is the proposed guidance operational?

See Question 7.

12. Do you agree that the carrying amount of all insurance contracts should be discounted if the effect is material? Do you agree with the proposed guidance on the discount rate that should be used to measure the carrying amount of insurance contracts? If not, which discount rate should be used?

We believe that current GAAP accounting for insurance contracts is adequate. However, if discounting of reserves is required, the discount rate used in the measurement of the liabilities should be reflective of the characteristics of the insurance liability and should reflect how the products are priced and managed. The proposed guidance starting with a risk free rate adjusted for illiquidity premium does not adequately represent the characteristic of the liabilities and will create earnings volatility that will be difficult for financial statement users to understand. Due the absence of an observable market for insurance liabilities, the illiquidity premium is a very subjective rate that we believe will not be applied consistently among companies. Long-duration products that have explicit crediting rates (annuities) are not adequately addressed in the DP. In order to produce results that are indicative of the actual performance of such contracts and that are consistent with the way in which these products are managed and evaluated, we believe that
the discount rate for annuities and similar long-duration contracts should be based on one of the following:

- Since profitability is driven by the insurer’s ability to earn investment returns in excess of amounts credited to policyholders over the life of the contract, there is a critical link between the insurance liabilities and the assets that support those liabilities. Accordingly, the standard should allow a discount rate based on the insurer’s expected returns on assets held to support the liabilities in order to produce results that appropriately match the actual performance of the contracts.

- Alternatively, the Board should consider allowing a discount rate based on the yield curve for a “typical” insurer investment such as a “AA”-rated corporate bond in order to enhance comparability across entities. While this does not fully resolve the mismatch issue discussed in our letter, it would still introduce investment return based discounting.

- If discounting of reserves is required, the Board should consider whether the benefit of discounting liabilities associated with short-duration products is worth the cost. We do not believe this to be the case.

13. Do you think that acquisition costs should be included as one of the cash flows relating to the contract? If not, how would you account for acquisition costs?

Yes, expenses incurred to acquire an insurance contract should be recognized over the life of the contract. If discounted cash flows becomes the required model for all or certain insurance contracts, including acquisition costs as part of the cash flows effectively amortizes them over the life of the contract.

14. Do you agree that acquisition costs included in the cash flows used in the measurement of the insurance contract should be limited to those that are incremental at the individual contract level? If not, which acquisition costs, if any, would you include in the measurement of the insurance contract?

No, we believe that certain acquisition costs should be captured at the “portfolio of contracts” level. The guidance recently issued by FASB in ASU 2010-26 provides a reasonable definition of acquisition costs. Any new guidance should be conformed to the guidance that is already required to be adopted in 2012.

15. Do you agree with the use of either the composite margin approach or two-margin approach to measure the net insurance contract? Does either approach faithfully represent the economics of insurance contracts? Is either approach an improvement over the measurement used in current U.S. GAAP?

We do not believe that either the composite margin approach or two-margin approach is a significant improvement to current U.S. GAAP.
However, if a margin approach is adopted for long-duration contracts, we support the composite margin approach. We believe that the composite margin is essentially a deferred profit, which should be recognized over the life of the contract consistent with paragraph 83 (adjusted for changes in expected cash flows to provide a buffer for adverse development). We agree that interest should not be accreted as proposed in paragraph 92. We believe that more guidance is needed for determining the amortization pattern/formula for products like a single premium annuity where the entire premium is paid up front and the "claims" are not paid until the purchaser withdraws, surrenders or annuitizes. Based on the DP, it appears that the composite margin may not amortize until surrender, withdrawal or annuitization.

16. Do you think that the composite margin should be recognized in earnings in subsequent periods using the ratio described in paragraph 83? If not, how would you recognize the composite margin in earnings?

See Question 15.

17. Do you agree that interest should not be accreted on the composite margin? Why or why not?

See Question 15.

18. Do you think that all insurance contracts should be recognized and measured using one approach or that some insurance contracts should be recognized and measured using an alternative approach (for example, the modified approach)? Why or why not?

As stated in our response to DP Question 7, we believe that the risks inherent in the products and claim settlement period are significantly different between short-duration and long-duration contracts. We believe that current U.S. GAAP be retained for short duration contracts as it is understandable, relevant and comparable among similar companies.

19. If an alternate approach is required for some insurance contracts, what recognition, measurement, and presentation provisions should be applied (including those items noted in paragraph 106)?

See question 18.

20. Do both the building-block approach and the modified approach (with the latter approach applied only to certain short-duration contracts) produce relevant and decision-useful information? Why or why not?

We do not believe that that the building block or modified approach as currently defined in the DP would produce more relevant and decision-useful information than current U.S. GAAP. If the Board continues to pursue such an approach, the changes outlined in this letter would help make the building block approach produce relevant and decision-useful information for long-duration products. For short-duration products, the new approach would not be as transparent as current U.S. GAAP.
21. How should the scope of insurance products for each approach be defined (for example, duration of coverage period, duration of claims payment period, or type of insurance)?

The scope of insurance products for each approach should be defined as it is in current U.S. GAAP in ASC 944.

22. Are there specific types of insurance contracts for which the approaches would not provide decision-useful information?

See Question 20.

23. What are the implications of the recent U.S. healthcare reform to the application of the proposed contract boundary principle, including whether health insurance contracts written under the new reforms would meet the conditions in the proposed guidance to be accounted for under the modified approach?

No comment.

24. What other changes should be considered to both improve and simplify U.S. GAAP for short- and long-duration insurance contracts?

See question 32.

25. What are the incremental costs of adopting the alternatives described in this Discussion Paper? Please separately describe one-time costs and ongoing costs.

The incremental cost of implementing the guidance in the Discussion Paper would be significant and the changes could potentially impact most areas of the company. The most significant costs would be in the actuarial, accounting and information systems areas. One-time costs would include the creation of new and significantly increased complex actuarial models, extensive training, and revisions to information systems. Ongoing costs would include additional personnel required to meet financial statement regulatory deadlines and run all of the projections required to measure the liabilities. These ongoing costs will be significant due to the detailed level and frequency at which the proposed accounting would be required to be applied and reported. Maintaining discounted probability-weighted projected cash flows over time for portfolios defined by both product type and date of issuance would be onerous for many insurers.

If significant changes to U.S. GAAP are adopted, there should be enough lead time to enable insurers to make needed software modifications and other process conversions to implement the new rules.

Considering that current U.S. GAAP adequately addresses the accounting for insurance contracts in a manner that produces relevant and reliable results that are understood by investors and consistent with the way insurance businesses are managed and evaluated, we strongly believe
that the significant cost that would be incurred to implement a completely new insurance standard is not justified.

Reinsurance

26. The scope of the proposed guidance includes reinsurance contracts that an insurer issues or acquires. However, insurance contracts held directly by other policyholders would be excluded from the scope of the proposed guidance. Do you agree with this exclusion? Why or why not?

No comment.

27. Should there be symmetry between the recognition and measurement of reinsurance contracts and the underlying contract ceded?

We agree there should be symmetry between the recognition and measurement of ceded reinsurance and the underlying direct contract. However, we do not believe there should be symmetry between the reinsurer and the cedant (for a given reinsurance contract) as each company will apply company-specific assumptions related to expected cash flows for each contract.

Presentation and Disclosure

28. The margin presentation approach highlights the changes in the insurance liability, rather than the current approach in U.S. GAAP, which presents, among other items, premium revenues, benefits paid, operating costs, and changes in loss estimates. Would this change improve your understanding of the performance of an entity that provides insurance (for some types of insurance or for all)? Please explain.

No. We believe that information such as premiums and benefits are relevant and useful to the financial statement users. This type of information is critical to understanding the key profit drivers of insurance products including volume, growth, loss ratios and claims development. These measurements are key comparisons among companies. The margin approach would not provide sufficient information and would put greater emphasis on disclosures and other non-GAAP measures than the actual Statement of Earnings. As stated in our letter, we strongly encourage the Board to reach out to financial statement users to gauge their view of current U.S. GAAP and to educate them with respect to the IASB and FASB proposals, with subsequent assessment of their views regarding the benefits of the proposed changes.

29. Should insurance contracts measured under the building-block approach be presented using a margin presentation approach or a premium presentation approach that would require a true-up amount as described in paragraph 119 (for example, the written allocation presentation approach or the allocated premium presentation approach)?

See Question 28.
30. Should short- and long-duration (or nonlife and life) contracts be presented in a similar manner even if such contracts are measured under different approaches?

No. We believe that the presentation approach should vary by contract type (premiums and claims-focused versus spread-driven) in a manner that produces financial statements that are consistent with the way in which the business is managed and evaluated and that provides meaningful information to investors.

31. Do you agree with the proposed disclosures in the IASB’s Exposure Draft? Why or why not? If not, what would you recommend and why?

No. The proposed disclosures appear overly burdensome and excessive. We do believe in robust and meaningful disclosures for insurance contracts including sensitivity analysis to highlight the risks inherent in insurance products. The final disclosure requirements should be based on giving financial statement users information that is relevant and meaningful.

Additional Question for Respondents

32. After considering your views on the specific issues contained in this Discussion Paper and the IASB’s Exposure Draft, what do you think would represent the most appropriate improvement to U.S. GAAP?

a. Pursue an approach based on the IASB’s Exposure Draft?

b. Pursue an approach based on the IASB’s Exposure Draft with some changes? Please explain those changes.

c. Pursue an approach based on the Board’s preliminary views in this Discussion Paper?

d. Pursue an approach based on the Board’s preliminary views in this Discussion Paper with some changes? Please explain those changes.

e. Make targeted changes to address specific concerns about current U.S. GAAP (for example, items included in paragraph 7)? Please describe those changes.

Based upon the current IASB Exposure Draft and FASB DP, we believe the most appropriate approach is to make targeted changes to address specific concerns about current U.S. GAAP.

- We believe the current U.S. GAAP accounting model is robust, time-tested (including during the recent financial crisis), produces relevant and reliable results that are understood by investors, and reflects the way insurers price, manage and evaluate contracts. High quality accounting standards should not be sacrificed to achieve a global standard.

- We agree that the enhanced definition of insurance contracts and insurance risk under the FASB proposal and the application of consistent insurance liability measurement to
specific contracts regardless of the entity issuing the contract would be improvements to
current U.S. GAAP. (See DP Questions 1 and 2).

- For short-duration products, the accounting proposed in the DP would not be as
  transparent or useful as current U.S. GAAP.

- For most long-duration products, we believe that many of the principles outlined in the
  DP would be an improvement to current U.S. GAAP and could be accomplished by
  moving all long-duration products, including life and long-term care products to a
  method based on net cash flows and retaining the ASC 944 measurement approach for
  annuities. This would provide unlocking more frequently for life and long-term care
  products as the ultimate financial results for these long-term products are realized and
  reflect the lifetime assumptions as ASC 944 currently allows.

- Current U.S. GAAP could also be improved by requiring enhanced disclosures and
  sensitivity analysis on significant assumptions inherent in the measurement of long-
duration liabilities.