Via Email: director@fasb.org

December 15, 2010

Technical Director
File Reference No. 1870-100
Financial Accounting Standards Board
401 Merrit 7
Post Office Box 5116
Norwalk, CT 06856-5116

Re: FASB Discussion Paper, Preliminary Views on Insurance Contracts
    IASB Exposure Draft, Insurance Contracts

Dear Technical Director:

Lincoln National Corporation ("LNC" or "we") appreciates the opportunity to comment on the FASB Discussion Paper, Preliminary Views on Insurance Contracts ("FASB DP") and the IASB Exposure Draft, Insurance Contracts ("IASB ED"). LNC is a holding company which operates multiple insurance and retirement businesses in the United States through subsidiary companies. Through our business segments we sell a wide range of insurance, wealth protection, accumulation and retirement income products and solutions. As of September 30, 2010 we had consolidated assets of $190.5 billion.

The life insurance industry fills a critical role in ensuring the financial and retirement security of millions of Americans. The insurance contracts measurement model proposed in the FASB DP and IASB ED could damage our ability to fulfill this mission by introducing non-economic volatility and by impairing the understandability of our financial results. These challenges could make it difficult for our industry to compete for capital with other industries that have less volatile, more understandable results under their accounting models.

We support the efforts of the FASB and IASB to work jointly to arrive at a single standard for the measurement of insurance contracts. However, we believe that current U.S. GAAP has a well established set of standards that have served the industry well over the past several decades and any changes made to existing U.S. GAAP should be done so only after careful consideration and due process. Any change to existing U.S. GAAP should result in an improvement to the reliability and understandability of financial statements rather than resulting solely from a desire to converge with IFRS.

While we generally support the use of a building blocks measurement model for long-duration insurance contracts, we do not support the current measurement model described in the FASB DP and IASB ED, as there are several key issues that need to be revised before a major change to U.S. GAAP should be implemented. As proposed, we do not believe the measurement model represents an improvement over current U.S. GAAP or
that it would yield financial statements that are more reliable or more understandable. For example, the proposed measurement model could result in artificial losses at issue for products that are expected to be profitable over the longer term. We believe that if the guidance were to be adopted as proposed, it could have severe negative unintended consequences on the insurance industry in its ability to compete for capital and to provide needed accumulation and protection products to consumers. We are concerned with the proposed accounting model which does not fairly represent the economics of the underlying business, as it could drive companies to make decisions based upon accounting outcomes rather than the economics of its business model.

We support the use of a probability-weighted estimate of net cash flows that allows the use of entity specific assumptions to measure long-duration contracts; as such methodology is consistent with the underlying economics for our long-duration life insurance and annuity products. However, we believe the standard should clarify that this does not always require a full stochastic approach. We believe for certain types of insurance contracts or under certain circumstances it may be acceptable to use a single or limited number of possible scenarios.

Furthermore, we have several additional concerns with the proposed measurement model that need to be addressed, which are discussed below.

- **Timing of recognition**
  The measurement model in the FASB DP and IASB ED requires an insurance contract to be measured at the earlier of (a) when the insurer is bound by the terms of the insurance contract, and (b) when the insurer is first exposed to risk under the contract. We do not support this concept, and support the measurement of an insurance contract based on the effective date of the contract, as that is the date the insurer is exposed to risk and is required to perform under the terms of the contract.

- **Margins**
  We support the composite margin approach proposed by the FASB DP and do not support the risk/residual two-margin approach proposed by the IASB ED. The calculation of a separate risk margin would be very subjective, even arbitrary, and would result in an inappropriate perception of accuracy regarding the risk associated with insurance liabilities. In addition, the use of the risk/residual two-margin approach could result in artificial losses at issue for certain products that are expected to be profitable in the long term.

- **Unbundling**
  We do not support the proposed guidance in the FASB DP and IASB ED on unbundling. As proposed, the guidance could result in unbundling product features that are interdependent with the insurance component, causing changes to the nature of the insurance component of the contract and causing unintended consequences related to these insurance products. We would define
interdependent features as those features whose value is derived from the underlying insurance contract.

In general, we only support unbundling product features that are not interdependent with the host insurance contract. It is not appropriate to unbundled interdependent features, as the unbundling of these features is inconsistent with the building block methodology, which suggests a holistic approach to measuring the obligation associated with a given insurance contract. The unbundling of interdependent product features would change the nature of the insurance component of the contract and would result in a measurement that was not meaningful for insurance components of the contract or the contract as a whole. For contracts with interdependent features, allocating premium to the separate product features will be purely arbitrary, as the product is generally priced as a whole and profitability is evaluated on the whole product, as opposed to each feature associated with the given product.

We do not agree with the assertion that account values are not clearly and closely related to the underlying insurance contract in all cases, as some account values can be used to fund the insurance benefits provided to policyholders or to pay premiums due under a contract. Therefore, unbundling is not appropriate for universal life-type insurance contracts.

We do not support unbundling of variable annuity contracts with guarantees, including embedded derivatives that are currently bifurcated under U.S. GAAP, since the fair value would be very close to the value one would get under the current fulfillment model. In order to appropriately account for the various features and settlement options of annuity contracts, we support their inclusion in the measurement of the liability through the probability weighted estimates of net cash flows associated with these contracts. This measurement approach will result in a liability associated with the contract obligation based on the various settlement options without arbitrarily unbundling interdependent features of the annuity contract, and will result in a liability that is consistent with the assets used to back that liability.

We do support unbundling where the option value is determined solely on its own without any reference to the value of the insurance host contract, e.g. indexed annuity products. Unbundling such features which are not interdependent with the host insurance contract would not change the nature of the insurance component of the contract; therefore, the unbundling would result in a meaningful measurement of the insurance contract and the contract as a whole.

- **Discount rate**
We do not support the use of a risk-free rate adjusted for illiquidity because there exist other, more appropriate, alternatives. We support the recommendations in the letter submitted by the American Council of Life Insurers on discount rates dated November 22, 2010.
We agree that the discount rate should reflect the characteristics of the insurance contract liability. Due to the long-term nature of liabilities for long-duration insurance contracts, we believe the discount rate should be a stable rate that is consistent with how we price our products and manage our business. When pricing long-duration products, companies generally take into account the long term nature of the liabilities and the cost of financing and design the products in a manner that creates cash flows to meet the objective of desired return and cost of capital. Long-duration insurance contracts do not represent a liquid liability that can be actively traded in the marketplace. Similarly, shareholders make an investment in insurance companies with a long-term view of their investment in the company. These facts would support that a longer term view of the discount rate for long-duration products is appropriate and we suggest the use of a more stable discount rate that is consistent with how companies price products, such as an asset-based rate or a cost of capital rate, which would be consistent with a company's business model.

- Acquisition costs
  While we support the inclusion of acquisition costs in the probability-weighted net cash flows used to measure the insurance liability, we do not support the definition of acquisition costs in the FASB DP and IASB ED, which only include incremental acquisition costs in the present value of the fulfillment cash flows. Including only incremental acquisition costs could result in a different measurement of similar contracts based on the business model of the insurer. For example, an insurer who outsources its underwriting function would be permitted to include those costs in its cash flows, as they are incremental costs. However, an insurer who performs underwriting in-house would not be permitted to include those costs in its cash flows, as they are not incremental costs at an individual contract level. This could cause companies to make changes to its business model for certain functions in order to achieve more desirable accounting results. We believe that changes in accounting should not drive changes in a company’s business model; therefore, we request consideration of the following.

In October 2010, the FASB issued Accounting Standards Update No. 2010-26, “Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts” (“ASU 2010-26”), which clarifies the types of costs incurred by an insurance entity that can be capitalized in the acquisition of insurance contracts. ASU 2010-26 defines acquisition costs as those costs incurred which result directly from and are essential to the successful acquisition of new or renewal insurance contracts and includes incremental acquisition costs as well as those costs that are related to activities associated with the successful acquisition of new and renewal contracts. We urge the FASB to carry forward the guidance in ASU 2010-26 and IASB to incorporate the guidance in ASU 2010-26 on acquisition costs into the final standard on insurance contracts.
• **Modified approach**
  We support the use of a modified approach for short-duration contracts, including certain group contracts such as group life insurance, short-term disability, dental, etc., as we believe the use of the building-blocks measurement approach would not result in meaningful or decision-useful information for these contracts. We do not support the definition of short-duration included in the FASB DP and the IASB ED, as we believe it is too prescriptive and would result in some of these contracts not qualifying for the modified approach. We support removal of the bright line 12 month definition and inclusion of a more principles-based definition consistent with the one that currently exists under U.S. GAAP. In addition, because of the short-term nature of these contracts, we do not support discounting of the pre-claims liabilities.

• **Transition**
  We believe a guiding principle related to the transition guidance should be to preserve the profit embedded in the inforce business for long-duration contracts. We do not support the current transition guidance, which, as currently proposed in the IASB ED, would force both an overstatement of equity at the time of transition and an understatement of earnings for several decades following the transition. We support the use of a simplified approach to calculating the residual margin (in the case of the IASB ED) or the composite margin (in the case of the FASB DP) upon transition in order to satisfy the guiding principle of preserving the profit on the inforce and suggest several possible alternatives in our responses to the questions in the Appendix to this letter.

We believe that the transition guidance as proposed in the IASB ED could result in unintended consequences, including market disruption related to the insurance industry, as it would result in significant changes to the profit emergence of inforce business. Such a significant change could result in confusion about the underlying drivers of the insurance business, resulting in a redirection of market capital away from the industry.

Any change to U.S. GAAP should allow for sufficient lead time to implement. Implementing and maintaining the proposed accounting model would require significant systems and process changes and ongoing resource commitment to produce the various fair value/margin calculations on a quarterly basis, all at a significant cost to the shareholder. This reduction in shareholder value would not be justified if investors are not able to use the information provided by the new measurement model to make a more informed investment decision. We do not believe sufficient benefits will emerge to justify this increased cost of the proposed measurement model.

• **Reinsurance**
  We believe greater clarity is needed regarding the accounting for reinsurance contracts. We support symmetry between the recognition and measurement of
reinsurance contracts and the underlying direct contract for coinsurance, but believe that for other types of reinsurance contracts, symmetry between the reinsured contract and the underlying direct insurance contract may not always be appropriate. For these reinsurance contracts the direct writer and the reinsurer may use consistent cash flows, but entity specific assumptions may differ; therefore, symmetry is not appropriate.

- **Income statement volatility**
  We believe that the application of the measurement model that is proposed in the FASB DP and the IASB ED will result in unnecessary income statement volatility that is inconsistent with the economics of the business. The obligations associated with long-duration life insurance contracts are long-term in nature and ultimately result in settlement under the terms of the contract. We believe that changes to assumptions used in the measurement of long-term insurance obligations should be tied to long-term economic and experience expectations rather than to constantly changing short-term market conditions which would lead to unnecessary volatility in earnings. As a result, reporting periodic income statement volatility due to short term fluctuations in assumptions, such as the discount rate, on a long term obligation would not provide meaningful or decision-useful information for users of financial statements, as such volatility is inconsistent with the underlying economics of the business obligations. As a result, we believe that this could lead to the development of other models to be used to explain the economic results of the business to investors and other users of financial statements.

A separate model that takes a long-term view regarding the measurement of insurance contract liabilities should be available as an option for certain products to the extent such a model would be consistent with the business model for those products. Such a model would result in assumptions being remeasured or "unlocked" when certain triggering events necessitate a change in assumptions, but would not result in a continuous, periodic remeasurement of assumptions where such remeasurement would be inconsistent with the business model for a given product. Such an option would mitigate the artificial income statement volatility noted above.

Another alternative to mitigate the volatility introduced by the measurement model that is proposed in the FASB DP and the IASB ED would be to permit the continuous, periodic remeasurement of assumptions to be recorded to Other Comprehensive Income as opposed to remeasuring all assumptions through the income statement.

These options should be considered in combination with the Financial Instruments project, to ensure consistency with the assets that support the insurance contracts liabilities.
• **Presentation and Disclosure**

We do not support the proposed margin presentation approach. We believe that this presentation approach is not only a fundamental change from current practice, but may misrepresent the economics of the business and could result in a loss of essential information for users of financial statements. It also could lead to a redirection of capital from the insurance industry to other financial institutions, causing adverse impact on the insurance industry.

While we agree with the disclosure principle contained in the FASB DP and the IASB ED, we believe the proposed guidance as drafted will not improve the ability of investors, analysts and other users of financial statements to understand the challenges, risks and opportunities of an insurance company. In addition, the proposed guidance as drafted is overly burdensome, which will result in increased cost to the preparer, which hurts shareholder value if investors are not able to use the information to make a more informed investment decision.

The focus of any changes to disclosure requirements should be to provide clear, concise and informative information about the most significant risks, challenges and opportunities that drive shareholder value. This requires the ability to use judgment and the current guidance is too prescriptive. As currently drafted, the proposed guidance appears to focus on disclosing additional data, much of which is very complicated and voluminous, which could ultimately lead to misinterpretation by users.

The items discussed above represent our key areas of concern with the proposed guidance on insurance contracts. These issues are further discussed in our answers to the questions posed in the FASB DP and in our answers to selected questions posed in the IASB ED, as they relate to the key issues identified above. We appreciate the opportunity to express our views on issues related to the FASB DP and the IASB ED. Our detailed answers to the questions posed in the FASB DP and to selected questions posed in the IASB ED are included in the attached appendix. If you have any questions regarding our comments please contact me at (484) 583-1430.

Sincerely,

Douglas N. Miller
Vice President and Chief Accounting Officer
Responses to Questions

Definition and Scope

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

Yes. We believe the proposed definitions of insurance contract and insurance risk are understandable and operational. We support the Board’s conclusion to apply the guidance in the FASB DP to all insurance contracts, regardless of the type of entity that issues the contract. We believe this will improve comparability among entities that issue similar contracts.

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. We support the scope of the proposed guidance based on the definition of an insurance contract rather than on the type of entity issuing the contract. By defining the scope in this manner, it will ensure consistency in measurement of similar types of contracts, regardless of the nature of the entity that issued the contract. Such consistency would be an improvement in financial reporting.

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

We agree with the proposed scope exclusions listed in paragraphs 28 and 29 of the FASB DP.

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?

Benefits that an employer provides to its employees that otherwise meet the definition of insurance are compensation expense as opposed to insurance. Therefore, we agree that such benefits should not be within the scope of the proposed guidance.

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 do not issue participating investment contracts; therefore, we are not providing a response to this question.
Responses to Questions

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

We do not support the proposed guidance in the FASB DP on unbundling. As proposed, the guidance could result in unbundling product features that are interdependent with the insurance component, causing changes to the nature of the insurance component of the contract and causing unintended consequences related to these insurance products. We would define interdependent features as those features whose value is derived from the underlying insurance contract.

In general, we only support unbundling product features that are not interdependent with the host insurance contract. As such, we do not support the approach for determining when noninsurance components of contracts should be unbundled, as discussed in paragraphs 39-42 of the FASB DP. The application of these paragraphs based on the examples provided would result in the unbundling of features of life insurance contracts that are interdependent with the host insurance contract.

It is not appropriate to unbundle interdependent features, as the unbundling of these features is inconsistent with the building-block methodology, which suggests a holistic approach to measuring the obligation associated with a given insurance contract. The unbundling of interdependent product features would change the nature of the insurance component of the contract and would result in a measurement that is not meaningful for the insurance components of the contract or the contract as a whole. For contracts with interdependent features, allocating premium to the separate product features will be purely arbitrary, as the product is generally priced as a whole and profitability is evaluated on the whole product, as opposed to each feature associated with the given product. To then unbundle interdependent components and arbitrarily allocate cash flows to the individual components of the contract would be inconsistent with fundamental principles of the measurement model and would not provide meaningful or decision useful information.

We do not agree with the assertion that account values are not clearly and closely related to the underlying insurance contract in all cases, as some account values can be used to fund the insurance benefits provided to policyholders or to pay premiums due under a contract. Therefore, unbundling is not appropriate for universal life type contracts.

We do not support unbundling variable annuity contracts with guarantees, including embedded derivatives that are currently bifurcated under U.S. GAAP, since the fair value would be very close to the value one would get under the current fulfillment model. In order to appropriately account for the various features and settlement options of annuity contracts, we support their inclusion in the measurement of the liability through the probability weighted estimates of net
Responses to Questions

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Appendix

cash flows associated with these contracts. This measurement approach will result in a liability associated with the contract obligation based on the various settlement options without arbitrarily unbundling interdependent features of the annuity contract, and will result in a liability that is consistent with the assets used to back that liability.

We do support unbundling where the option value is determined solely on its own without any reference to the value of the insurance host contract, e.g. indexed annuity products. Unbundling such features which are not interdependent with the host insurance contract would not change the nature of the insurance component of the contract; therefore, the unbundling would result in a meaningful measurement of the insurance contract and the contract as a whole.

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?

We generally agree with the use of the probability-weighted estimate of net cash flows that allows the use of entity specific assumptions to measure long-duration insurance contracts. In many cases the use of probability-weighted cash flows exists today in arriving at management’s best estimate to determine insurance liabilities in the application of current U.S. GAAP. However, we believe the standard should clarify that this does not always require a full stochastic approach. The use of probability-weighted net cash flows is consistent with a pricing view to determine ultimate cash flows; therefore, this methodology is consistent with the economics of the insurance contracts. We believe that the use of a single measurement methodology for long-duration insurance contracts is an improvement over existing U.S. GAAP, which has a mixed-model of accounting requirements for measuring insurance liabilities. One weakness in the current model under U.S. GAAP is that the fragmented nature of the existing guidance will often result in the measurement of individual components of a given insurance contract that does not equal the obligation of that contract as a whole. We support a building-blocks approach that allows the use of entity specific assumptions, as it takes a more holistic view of the insurance contract, which is more consistent with the economics of the contract and, we believe, an improvement over current U.S. GAAP.

We believe the most significant challenge is determining the level of aggregation that is appropriate in estimating probability-weighted net cash flows. We believe that it is appropriate for portfolios to be more granular in some cases but more aggregated in other cases based on the nature of the underlying business that is being measured. We believe that flexibility in the definition of “portfolio” would mitigate concerns associated with being able to perform this analysis on a quarterly basis. Therefore, we encourage the Board to continue the development of the standard in a “principles-based” manner to allow the actuarial professionals
the flexibility to develop sound practices to develop the probability-weighted estimate of net cash flows in a level of aggregation that is appropriate given the nature of the underlying contracts. We would urge the Board not to provide significant implementation guidance regarding this definition and to permit companies to use professional judgment in determining the level of aggregation appropriate in defining a portfolio based on the underlying business.

8. Do you think that an entity’s estimate of the net cash flows should include a risk adjustment margin?

We do not support the inclusion of an explicit risk adjustment margin in an entity’s estimate of the net cash flows. We support the use of a single composite margin, as described in the FASB DP, as the use of a single composite margin includes an implicit risk margin while providing for other margins as well. We do not think that a risk margin should be separated out from the other margins that are implicit in valuing liabilities for insurance contracts, as this implies a level of precision in calculating such a risk margin that does not exist in practice.

The use of a single composite margin with accompanying disclosure of the nature of various risk elements associated with the significant portfolios of insurance contracts would be most appropriate and would provide meaningful and decision-useful information to users of financial statements.

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?

We do not support the risk/residual margin approach and would not support limiting the calculation of a risk margin to three techniques. The stated objective of the risk margin is to 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; however, we believe the objectives of the risk margin can be satisfied implicitly through the composite margin, as opposed to the two-margin approach. The use of an explicit risk margin would suggest a level of precision that does not exist and would not result in meaningful and decision-useful information for users of financial statements. Furthermore, the principle of representing the maximum amount the insurer would rationally pay to be relieved of the risk associated with the fulfillment cash flows is inconsistent with how insurance contracts are ultimately extinguished, as insurers are relieved from risk by settling with the contract holder under terms of the contract, not by transferring the risk to a third party. Furthermore, this principle is consistent with an exit price notion, which was rejected by constituents through the comment process on the IASB Discussion Paper, Preliminary Views on Insurance Contracts.
Responses to Questions

We believe that the process of separately calculating a risk margin will be highly subjective, even with the three techniques identified in the FASB DP. As a result, there will be a lack of comparability among companies within the industry; therefore, identifying and reporting the risk margin in the financial statements would be misleading to users of financial statements.

We do not believe the techniques for estimating the risk adjustment margin listed in paragraph 52b are the only techniques that can be used to satisfy the objective. Therefore, if an explicit risk margin is required, we do not support the limitation of its calculation to these three techniques. The standard should state the principle and allow the actuarial profession to develop an appropriate methodology based on the business mix at each individual company. This will allow for the use of different methods as methods are developed in the future, without requiring changes to accounting standards to permit their use.

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

No. As currently written, the IASB ED proscribes the use of three possible methods to compute the risk margin. These methods are not consistent with the definition of risk margin included in the IASB ED, and diversity in practice will exist resulting in comparability issues. While we do not support the use of an explicit risk margin, if one is required we believe that management’s judgment should be used to determine the appropriate methodology for calculating the risk margin based on the type of risk that the entity is exposed to for a given portfolio of products. In this way, industry practice will develop regarding the use of risk margins for particular types of risk, which will eventually lead to greater comparability where such comparability is appropriate. This will also allow for the use of different methods as methods are developed in the future, without requiring changes to accounting standards to permit their use.

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?

Yes. We agree with the description of cash flows that should be included in the measurement of an insurance contract. In general, we believe the proposed guidance is operational based on the nature of business that we write, generally long-duration life insurance and annuity products.
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 agree that the carrying amount of insurance contracts should be discounted for long-duration contracts if the effect is material. However, we do not support discounting for short-duration contracts.

We do not support the use of a risk-free rate adjusted for illiquidity because there exist other, more appropriate alternatives.

We agree that the discount rate should reflect the characteristics of the insurance contract liability. Long-duration insurance contracts do not represent a liquid liability that can be actively traded in the marketplace. Due to the long-term nature of long-duration life insurance contracts, we believe the discount rate should be a stable rate that is consistent with the long-term nature of the contracts, the pricing view of the products and the business strategy of the insurer for a given portfolio, and believe that there are other discount rates that would be more appropriate than a risk-free rate adjusted for liquidity for many portfolios that are issued by insurers.

We support the recommendations in the letter submitted to the Board by the American Council of Life Insurers on discount rates dated November 22, 2010. In addition, we note the following concerns and offer the following comments.

The definition of liquidity adjustment is unclear and it is unclear how a company would calculate such an adjustment. If the goal is to discount at an appropriate rate based on the risk in the liability, then we believe other methods would be appropriate, including using cost of capital for publicly traded companies, or using an asset based rate with some adjustment, i.e. for credit risk inherent in the asset.

The use of an asset based rate to discount liabilities would be consistent with the long-term nature of the life insurance contracts and the business strategy of the insurer, whereby assets are acquired to achieve a cash flow matching related to the expected cash flows associated with the obligations measured by the insurance liabilities.

The use of a cost of capital rate would be consistent with valuation of the company as a whole associated with goodwill and intangible asset valuation for impairment testing purposes. This rate would be appropriate for publicly traded companies; however, we acknowledge the limitations associated with privately-held or mutual insurance companies.
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. We support the inclusion of acquisition costs as one of the cash flows relating to 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?

We do not support the definition of acquisition costs included in the FASB DP, which is even more limiting than recent changes made to U.S. GAAP, resulting in the codification of Accounting Standards Update No. 2010-26, “Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts” (“ASU 2010-26”). ASU 2010-26 defines acquisition costs as those costs incurred which result directly from and are essential to the successful acquisition of new or renewal insurance contracts. The definition that is proposed in the FASB DP would be even more limiting, as it would not include all costs that are related to activities associated with the successful acquisition of new or renewal contracts.

Our concern with further limiting the definition of acquisition costs, as currently defined in the FASB DP, is that it could result in different measurement of similar contracts based on the business model of the insurer. For example, an insurer who outsources its underwriting function would be permitted to include those costs in its cash flows, as they are incremental costs. However, an insurer who performs underwriting in-house would not be permitted to include those costs in its cash flows, as they are not incremental costs at an individual contract level. This could cause companies to make changes to its business model for certain functions in order to achieve more desirable accounting results. We believe that changes in accounting should not drive changes in a company’s business model.

We support the definition of direct and incremental cash flows included in ASU 2010-26 and believe this guidance should be carried forward into the final guidance on insurance contracts and that the costs defined as direct and incremental in ASU 2010-26 should be included in the net cash flows of the insurance contract based on the measurement model proposed by the FASB DP.

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 support the use of the composite margin approach as described in the FASB DP. This approach more faithfully represents the economics of the insurance contracts, the measurement of which takes into account many types of risk, than
the two-margin approach. Included in the measurement of insurance liabilities are several different types of margins, one of which is a risk margin. The explicit measurement of a risk margin would suggest a level of precision regarding this particular margin that does not exist, which would not result in meaningful or decision useful information for users of financial statements. Furthermore, the explicit measurement of a risk margin would minimize the importance of other margins in the measurement of the liability, including mortality risk, interest rate risk, etc.

The use of the composite margin does not ignore risk margin. Risk margin is implicit in the composite margin, along with other risk associated with the insurance contract liability. We support such an inclusion of an implicit risk margin within the composite margin, but do not support the use of an explicit risk margin calculated using one of the three proscribed methods described in the IASB ED. We believe that the arbitrary use of one of these methods will decrease the meaningfulness and usefulness of financial statements and suggest that there are other methods that would also be appropriate. The limitation of companies to the use of three arbitrary methods would not result in meaningful comparability. However, the use of a single composite margin accompanied by robust disclosure of the various risks associated with the portfolio of contracts would increase transparency and understandability of the underlying business being measured.

In addition, we support the subsequent measurement of the composite margin as described in the FASB DP.

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?

We support the release of the composite margin as the insurer is relieved from risk associated with the contract. The subsequent measurement method for the composite margin as described in paragraph 83 is a reasonable method for approximating how an insurer is released from risk; however, we would suggest a principles-based approach that would allow the use of additional methods based on a company’s business model, supplemented by disclosure of the method used.

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

We agree that interest should not be accreted on the composite margin. This would add complexity to the insurance liability measurement and would not be meaningful to the user of the financial statements.
Responses to Questions

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?

We support a two-model approach and think that a building blocks approach is appropriate for long-duration contracts, but that a separate model is needed for short-duration contracts. However, we do not believe the premium allocation model that is outlined in the IASB ED is appropriate for short-duration contracts. We would support the maintenance of the unearned premium reserve approach under current U.S. GAAP (FAS 60) for measurement of short-duration insurance contracts. A two-model approach would more appropriately reflect the underlying economics of the different business models associated with long-duration and short-duration contracts.

In addition, we do not support the current definition of short-duration contracts as outlined in the IASB ED. This definition would result in a modified model only being applied to contracts with a coverage period of 12 months or less and that do not contain embedded options or other derivatives. We have certain short-duration contracts that we are concerned would not meet this definition due to rate guarantees associated with these contracts. However, the use of a modified model is appropriate for these contracts as they include contracts such as group life insurance policies, short-term disability contracts, dental contracts etc. Therefore, we support a revised principles-based definition of short-duration contracts, whereby the insurance contract should be classified as short-duration or long-duration based on whether the contracts are expected to remain in force for an extended period. Such definition would be consistent with the current definition in U.S. GAAP (FAS 60).

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)?

If an alternative approach is required for short-duration insurance contracts, direct and incremental acquisition costs (based on the changes to the definition discussed in our response to question #14) should reduce the pre-claims liability, to the extent those costs are material.

Due to the nature of the pre-claims liability for short-duration contracts, interest should not be accreted on the carrying amount of the pre-claims liability. Due to the short-term nature of the pre-claims liability for short-duration contracts, any accretion of interest would not be material and, therefore, would not be meaningful to the measurement of the liability.

We believe that a premium deficiency test, as required under current U.S. GAAP, is sufficient. An onerous test that requires the continuous computation of fulfillment cash flows at a more granular level than that required under today’s
Responses to Questions

premium deficiency test should not be required as this would be inconsistent with the use of a simplified approach for short-duration contracts.

We support a single presentation model for all insurance contracts, regardless of the measurement model. Our comments on the proposed presentation model are included in our responses to questions #28-31.

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?

The use of a two-model approach that would result in the use of a building-block approach for long-duration contracts and the use of a modified approach for short-duration contracts, based on the modifications suggested to each model in this letter, would produce relevant and decision-useful information. As such, an approach would be consistent with the different business models that exist for these different types of businesses.

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 consistent with current U.S. GAAP. The insurance contract should be classified as short-duration or long-duration based on whether the contracts are expected to remain in force for an extended period. We do not support the current definition of short-duration contracts in the IASB ED, as we believe it is too prescriptive.

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

The building block approach would not provide decision-useful information for short-duration contracts, including certain group life contracts, e.g. short-term disability, group life, dental, etc. Such contracts would be better measured using a modified approach, similar to the unearned premium reserve method in current FAS 60.

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?

We do not issue health insurance contracts; therefore, we are not providing a response to this question.
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24. What other changes should be considered to both improve and simplify U.S. GAAP for short- and long-duration insurance contracts?

In addition to the modifications to the proposed guidance in the FASB DP noted throughout this letter, we believe a separate model that takes a long-term view regarding the measurement of insurance contract liabilities should be available as an option for certain products to the extent such a model would be consistent with the business model for those products. Such a model would result in assumptions being remeasured or “unlocked” when certain triggering events necessitate a change in assumptions, but would not result in a continuous, periodic remeasurement of assumptions where such remeasurement would be inconsistent with the business model for a given product. Such an option would mitigate our concerns regarding the artificial income statement volatility that would result from the measurement model proposed in the FASB DP as noted above in the cover of this letter.

Another alternative to mitigate the volatility introduced by the measurement model that is proposed in the FASB DP and the IASB ED would be to permit the continuous, periodic remeasurement of assumptions to be recorded to Other Comprehensive Income as opposed to remeasuring all assumptions through the income statement.

These options should be considered in combination with the Financial Instruments project, to ensure consistency with the assets that support the insurance contracts liabilities.

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

One time costs of adopting the guidance proposed in the FASB DP include:

1. Costs to upgrade the valuation modeling applications to perform stochastic modeling at the volume that will be required.
2. Costs to upgrade actuarial staff.
3. System costs related to maintaining the data required for disclosure, including the disclosure of alternative scenarios and alternative assumptions.

Ongoing costs related to the maintenance of the guidance proposed in the FASB DP include:

1. Costs to upgrade valuation actuarial staff
2. System costs related to maintaining the data required for disclosure, including the disclosure of alternative scenarios and alternative assumptions.
Responses to Questions

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?

Yes, we agree with excluding policyholder accounting from the scope of the proposed guidance. Applying the guidance in the FASB DP to policyholders would be overly burdensome and would not result in meaningful or decision useful information for users of financial statements of the policyholder.

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

We believe greater clarity is needed regarding the accounting for reinsurance contracts. We support symmetry in the case of coinsurance but believe that for other types of reinsurance contracts, symmetry between reinsurance and the direct contract is not always appropriate. For coinsurance, we believe that reinsurance measurement should follow the measurement model used for the underlying direct insurance contract. However, for other types of reinsurance contracts symmetry may not be appropriate as the direct writer and reinsurer may use consistent cash flows, but entity specific assumptions may differ.

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.

We do not support the proposed margin presentation approach. We believe that this presentation approach is not only a fundamental change from current practice, but may misrepresent the economics of the business and could result in a loss of essential information for users of financial statements. It also could lead to a redirection of capital from the insurance industry to other financial institutions, causing adverse impact on the insurance industry.

Both the changes in the insurance liability as well as metrics such as premium revenues, benefits paid, operating costs and changes in loss estimates are important and provide meaningful and decision useful information for users of financial statements and therefore merit equally prominent presentation on the face of the financial statements. Providing for disclosure of premium and benefit metrics in the financial statement footnotes does not satisfy the needs of financial statement users.
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)?

We believe that insurance contracts measured under the building-block approach should be presented using a presentation approach similar to the Alternative 2 written premium approach found in the FASB DP. In our view, such a presentation approach would represent a superior presentation view to the summarized margin approach as it presents such key performance metrics as premiums, claims, benefit payments, and expenses on the face of the financial statements rather than relegating those items to disclosure in the footnotes to the financial statements.

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?

We believe that short- and long-duration contracts should be presented in a similar manner even if such contracts are measured under different approaches. We believe that different presentation formats for short-duration and long-duration contracts further complicates the presentation model.

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?

We support the use of high-quality transparent disclosures to provide meaningful and decision useful information to users of financial statements. While we agree with the disclosure principle contained in the IASB ED, we believe the proposed guidance as drafted will not improve the ability of investors, analysts and other users of financial statements to understand the challenges, risks and opportunities of an insurance company. In addition, the proposed guidance as drafted is overly burdensome, which will result in increased cost to the preparer, which hurts shareholder value if investors are not able to use the information to make a more informed investment decision.

The focus of any changes to disclosure requirements should be to provide clear, concise and informative information about the most significant risks, challenges and opportunities that drive shareholder value. This requires the ability to use judgment and the current guidance is too prescriptive. As currently drafted, the proposed guidance appears to focus on disclosing additional data, much of which is very complicated and voluminous, which could ultimately lead to misinterpretation by users.
Responses to Questions

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.

We support convergence between IFRS and U.S. GAAP for insurance contracts accounting. However, recognizing that in the U.S. we have a comprehensive framework for insurance contract accounting, great care must be taken in evaluating an approach for making improvements to accounting for insurance contracts under U.S. GAAP. Current U.S. GAAP provides a uniform and consistent representation of the financial performance of insurance contracts, is well tested, and understood by financial statement users. Given the long established comprehensive framework exists under U.S. GAAP, targeted changes to these existing standards could be the best alternative.

However, depending upon the number and complexity of the changes which may be required for long-duration products an approach that starts with the preliminary view in the FASB DP with changes suggested in our comment letter to the Board may be appropriate. Suggested changes include:

i. The use of entity-specific assumptions in probability weighted cash flows and removing the requirement for an inclusion of all possible scenarios;

ii. The use of a composite margin in the building-block approach;

iii. Changes to the guidance on discount rate;

iv. Modification to the definition of acquisition costs to be consistent with ASU 2010-26;

v. Significant modifications to the unbundling guidance;

vi. Requirement to use a modified approach for short-duration contracts, based on the definition of short-duration contracts under current U.S. GAAP (FAS 60);

vii. Clarification of reinsurance accounting;

viii. Provision for the use of a separate model that takes a long-term view regarding the measurement of insurance contract liabilities for products to the extent such a model would be consistent with the business model for those products. Such a model would result in assumptions being remeasured or “unlocked” when certain triggering events necessitate a change in assumptions, but would not result in a continuous, periodic
Responses to Questions

remeasurement of assumptions where such remeasurement would be inconsistent with the business model for a given product.

However, if these changes are not addressed and resolved in an appropriate manner the resulting accounting model will not represent an improvement over U.S. GAAP. Therefore, in this case we would recommend targeted changes to U.S. GAAP.

In addition, the plans of the SEC for incorporating IFRS into the U.S. financial reporting system must be considered. It would be burdensome for U.S. insurers to make significant targeted changes to U.S. GAAP followed shortly thereafter by a significant undertaking to convert from U.S. GAAP to IFRS.

For short-duration contracts, we support an approach which would result in maintaining current U.S. GAAP (FAS 60) for short-duration contracts but making targeted changes to address the concerns in paragraph 7 of the FASB DP as applicable to short-duration contracts.

Questions in IASB Exposure Draft

In addition to the questions outlined in the FASB DP, we provide our comments on the following additional questions included in the IASB ED.

Question 15 – Unit-linked contracts
Do you agree with the proposals on unit-linked contracts? Why or why not? If not, what do you recommend and why?

We support the presentation of assets and liabilities related to unit-linked contracts as separate line items in the balance sheet. However, we do not support the proposed gross income statement presentation of revenue and expenses associated with unit-linked accounts in paragraph 78 of the IASB ED. These gross revenue and expense items represent risk to the account holder, not the insurance company. Therefore, to gross up the income statement by these amounts would not result in the presentation of meaningful and decision-useful information to users of financial statements. Rather, the income statement should present income and expenses from unit-linked accounts on a net basis, similar to current presentation under U.S. GAAP, as this represents the earnings to the insurer from unit-linked accounts. This net presentation would represent the most meaningful and decision-useful information as it relates to unit-linked accounts. We believe further clarification is required regarding the proposed gross income statement presentation of revenue and expenses associated with unit-linked accounts under the measurement model and summarized margin presentation approach proposed in the IASB ED.
Responses to Questions

Question 16 – Reinsurance

(a) Do you support an expected loss model for reinsurance assets?

While we agree that reinsurance assets should be evaluated for impairment, we do not support an expected loss model as described in the IASB ED. By considering the impact of non-performance by the reinsurer on an expected value basis when estimating the present value of the fulfillment cash flows, we are concerned this may result in a loss at inception of the reinsurance contract that is inconsistent with management’s expectations about the economics of that contract. While historical information may indicate that a loss is possible at the inception of the contract, a ceding company would not enter into a contract with a reinsurer if there were known or expected collection issues.

We support an evaluation of changes in the credit-worthiness of the reinsurer in the subsequent measurement of the reinsurance asset on an incurred loss basis, but not in the original measurement of the asset. Such evaluation should consider the financial surety of the reinsurance treaty itself when assessing the value of the asset.

(b) Do you have any other comments on the reinsurance proposals?

Yes. In addition to the comments noted on our response to FASB DP Questions #26 and #27 above, we note the following.

Further clarification is needed regarding paragraphs 45 (a) and (b) of the IASB ED to specify symmetry between the direct and reinsurance contract so that any reinsurance loss is deferred to be consistent with the gain that was deferred in the residual margin related to the direct contract and, likewise, any gain on the reinsurance contract should be recognized immediately to be consistent with the loss that was recognized immediately related to the direct contract, as this is not easily understood by the words in these paragraphs.

We have noted our general concerns with the timing of recognition in the proposed measurement model that would require an insurance contract to be measured at the earlier of (a) when the insurer is bound by the terms of the insurance contract, and (b) when the insurer is first exposed to risk under the contract. We also do not support the recognition provisions as they relate to reinsurance contracts. The timing of when reinsurance contracts are signed does not always coincide with the effective date of the contract. A contract may be signed prior to its effective date, or could be signed at a subsequent date and made effective retroactively to a prior effective date. This could introduce complexity into the measurement model; therefore, we support measurement of reinsurance contracts as of the effective date.
Responses to Questions

Question 17 – Transition and Effective Date

(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?

We do not support the proposed transition requirements, specifically the proposed guidance in paragraph 100(a) of the IASB ED. As the majority of our business is long-duration life insurance, a significant amount of our future profit will emerge from current inforce business. The result of applying this paragraph would force an overstatement of equity at the time of transition and an understatement of earnings for several decades following the transition. As a result, the transition guidance proposed by the IASB ED would significantly change the earnings patterns of companies like us who primarily write long-duration contracts. This would result in a significant amount of profit never being recognized through the income statement.

As stated in the opening section of our letter, we support a guiding principle related to the transition guidance that would preserve the profit embedded in the inforce business for long-duration contracts. We believe that the transition guidance as proposed in the IASB ED could result in unintended consequences, including market disruption related to the insurance industry, as it would result in significant changes to the profit emergence of our inforce business. Such a significant change could result in confusion about the underlying drivers of the insurance business, resulting in a redirection of market capital away from the industry.

Accordingly, we provide the following potential transition alternatives. The following is not meant to be an exhaustive list of potential alternatives, as we recognize that there may be other potential transition alternatives that we have not considered. We recognize that each alternative presented herein will require further investigation and modeling to determine whether it is a viable solution. However, we believe that the following alternatives, when supplemented by robust disclosure, could satisfy our guiding principle related to transition and represent better solutions that the transition guidance included in the IASB ED. Therefore, we request that the Boards consider the following:

Alternative #1:
As an alternative to the proposed transition guidance, we would support the approach outlined in paragraph BC249 of the IASB ED, which would have determined the residual/composite margin on transition to be the difference (but not less than zero) between (a) the carrying amount of the insurance liability immediately before transition and (b) the present value of the fulfillment cash flows at that date.

We understand the Board rejected this approach because the resulting residual margins would not have been comparable with residual margins for subsequent
contracts and would have depended significantly on the pattern of income recognition under previous accounting models, which are not uniform. However, we believe the benefit of maintaining the continuity of the previously reported profit and loss exceeds the inconsistency of comparing to the non-uniform previous accounting models.

We would suggest that financial statement disclosures be used to explain the impact of the transition guidance in BC249 to increase transparency to the financial statement user. In this way, companies will preserve the profit embedded in the in-force business and disclosures will aid users of financial statements in comparing the results among companies.

Alternative #2:
As an additional alternative, we suggest calculating the residual/composite margin on the date of transition as the difference between the insurance liabilities measured using the building blocks with original assumptions and the insurance liabilities measured using the building blocks with current assumptions. While this approach requires further investigation and modeling, it could provide a reasonable proxy for the residual/composite margin on the date of transition without requiring full retrospective application of the guidance.

Alternative #3:
While we recognize that full retrospective application would require significant effort and it is unclear whether companies would have the information available to apply the guidance retrospectively, we would support transition guidance that permits full retrospective application of the guidance at a company’s election. This alternative does not represent a simplified approach to transition, but we think it is one that should be explored as an alternative for inclusion in the insurance contract standard.

Regardless of the transition alternative selected, we note that the definition of portfolio might be substantially different between in-force and new business. We expect that the in-force models will have to be at a much more aggregate level than new business since it is highly likely that the necessary details to perform the valuations at a much lower level were never contemplated nor retained. We would recommend that the transition guidance be written in a manner that allows for flexibility in defining portfolios at different levels of aggregation for in-force and new business.

If transition guidance similar to alternatives 2 or 3 is pursued, we believe some type of “allocation” of building block pieces will be required. To that end, we acknowledge the subsequent valuation of the business, and emergence of earnings, would be dependent upon the quality of that allocation process.
(b) If the Board were to adopt the composite margin approach favored by the FASB, would you agree with the FASB’s tentative decision on transition (see the appendix to the Basis for Conclusions)?

We do not support the FASB’s tentative decision on transition, which is to set the composite margin equal to the risk margin on the date of transition. This would still result in 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. Therefore, we would recommend that the composite margin be calculated using the same guiding principle as the residual margin, one that would preserve the profit embedded in the inforce business for long-duration contracts, and believe the alternatives noted in our response to question 17(a) above should be considered.

(c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?

Yes, it is necessary for the effective dates for changes to guidance for insurance contracts and financial instruments to be consistent with each other. The insurance business model is reliant on asset liability matching; therefore, changes to the accounting for both sides of the balance sheet should be made on the same effective date to maximize consistency in measurement of insurance liabilities and the assets that support those liabilities.

(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

It is difficult to estimate the amount of time required to adopt to the proposed requirements because there are numerous areas of the proposed guidance that require clear and more effective guidance. Any change to U.S. GAAP should allow for sufficient lead time to implement, as such a significant change as the one being proposed will require companies to devote significant resources to make the required system and process changes in order to comply with the requirements. In addition, the cost to maintain the accounting model being proposed would require significant ongoing resource commitment to produce the various fair value/margin calculations on a quarterly basis. Once a final standard is issued, a lead time of at least three to five years will be required to ensure changes to information technology systems and related processes as well as to ensure proper accounting and disclosure for comparative periods.