November 16, 2007

Mr. Robert Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116
Sent via e-mail to: director@fasb.org

Re: File Reference No. 1540-100 – Invitation to Comment on the FASB Agenda
Proposal: Accounting for Insurance Contracts by Insurers and Policyholders,
Including the IASB Discussion Paper, Preliminary Views on Insurance Contracts.

Dear Mr. Herz:

The American Insurance Association (AIA) is pleased to provide its response to the FASB’s
Invitation to Comment on the Board’s proposal to develop an accounting standard for insurance
contracts. As an organization that represents major property & casualty insurance companies
that are based in North America and Europe, AIA is particularly interested in developing a high-
quality, global insurance accounting standard that properly reflects the nature and business of
insurance. We applaud the FASB’s interest in this project and encourage the Board to not only
take up this project, but to actively collaborate with industry to ensure access to the best
possible information as it proceeds with the project.

As AIA has stated in its comment letter responding to the IASB’s discussion paper, Preliminary
Views on Insurance Contracts (a copy of the AIA letter is included with this response), AIA
believes it is important not to portray dissimilar contracts as similar. In addition, contracts may
appear similar, but actually exhibit different economic characteristics because of differing legal
and business environments. Plus, each insurance enterprise may possess its own unique cost
structure and employ proprietary business strategies, both of which may lead to different
economic outcomes. An insurance accounting standard should not avoid varying results, but be
sufficiently flexible to reflect those differences. After all, it is the differences between competing
enterprises that investors and other financial statement users want to know about.

If the Board ultimately decides to take up this project – and we think it should – AIA has
developed a number of principles that it encourages the Board to consider in developing a
suitable insurance accounting standard:
• Reflect the legal and business environment of the insurance model, as well as the law of large numbers, the effects of diversification, and the management of claims on a portfolio basis.
• Provide a clear definition of insurance contracts and the scope of the guidance.
• Apply a measurement objective that reflects how property & casualty insurance contracts are actually settled.
• Measure pre-claim liabilities using the unearned premium reserve.
• Use entity specific cash flows to value post-claim liabilities when relevant industry data is unavailable.
• Recognize revenue as earned.
• Allow for the preparation of understandable, comparable and consistent financial statements that provide decision useful information to users in a cost-effective manner.

AIA looks forward to working with the Board in developing an insurance accounting standard. Please do not hesitate to call on us for any assistance.

Our comments to the specific questions raised in the Invitation To Comment follow.

Sincerely,

Phillip L. Carson
Assistant General Counsel
There is clearly a desire on both sides of the Atlantic and in other parts of the world to develop a comprehensive set of insurance accounting standard that can be used globally. In that the United States is probably the most important insurance and capital market in the year, it makes sense for U.S. standard-setters to take up the challenge of developing a high-quality, global accounting standard that could eventually facilitate convergence of standards.

a. What aspects of existing U.S. GAAP accounting for insurance contracts could be improved or simplified and how pervasive are these issues?

The FASB should use this project as an opportunity to truly move toward a principles-based framework for accounting standards. AIA has already provided a list of principles that the Board can consider in developing a new insurance accounting standard.

AIA believes that existing U.S. GAAP standards already provide sufficient guidance for property & casualty insurance. However, some perceived problems with existing GAAP could probably be appropriately addressed through more emphasis on disclosure.

b. How important is the development of a common, high-quality standard used in both the U.S. and IFRS jurisdictions?

Developing a common, high-quality standard is very important, as previously noted. Regulators and standard-setters in the U.S. and other countries have already begun the process of convergence but without having a common standard in place first. It is imperative for the FASB to step in and develop an appropriate insurance accounting standard, through which convergence can be accomplished.

Question 2: Are the preliminary views expressed in the IASB’s Discussion Paper a suitable starting point for a project to improve, simplify, and converge U.S. financial reporting for insurance contracts? If not, why not?

The International Accounting Standard Board’s Discussion Paper is not a suitable starting point for many reasons, as AIA has detailed in its comment letter to the IASB. Most significant of AIA’s concerns is the Discussion Paper’s conclusion that insurance liabilities should be valued based on a hypothetical transfer value. Such a notion has no basis in reality, in that insurance liabilities cannot be traded; rather, they are settled with the policyholder, as required by their insurance contracts. The Discussion Paper appears to proceed from the assumption that insurance contracts are similar to investment contracts, which are traded instruments. That predisposition toward investment contracts has led the Discussion Paper to inappropriate conclusions about insurance contracts as they pertain to property & casualty insurance liabilities.
We direct the FASB to AIA’s set of principles and encourage the Board to use them as its starting point.

a. Do you believe the preliminary views would be feasible to implement? If not, what aspects of the preliminary views do you believe could be difficult to apply and why?

The preliminary views of the IASB Discussion Paper cannot be feasibly implemented. It is premised on a hypothetical transfer value that could never be reflected in an insurer’s actual cash flows. It would require extensive modeling that could never be verified against real world information. Developing probability-weighted projections of all cash flows associated with a hypothetical transfer would be meaningless and difficult – possibly impossible – to produce, layering additional layers of uncertainty on top of uncertainty. AIA believes the resulting data would lack both relevance and reliability for financial statement users.

b. Are there other alternatives to improve or simplify U.S. financial reporting for insurance contracts that you would recommend? What would be the benefits of those alternatives to users of financial statements?

For property-casualty insurance, AIA believes that a more effective approach would be to focus on financial disclosure, as we stated in our response to Question 1a.

**Question 3**

Is there a need to address accounting by policyholders in an insurance contracts project? Why? If yes, should accounting by policyholders be addressed at the same time as the accounting by insurers? Can or should that wait until after the accounting by insurers is completed?

Policyholders are varied; their accounting informational needs, as well as the informational needs of their financial statement users, are not driven by insurance accounting. Therefore, we see no need to link policyholder accounting with insurer’s accounting and we do not believe policyholder financial reporting issues, if any, should addressed in the context of developing an overall accounting standard for insurers.

**Question 4**

How would you address the interaction between the accounting for insurance contracts and the FASB’s other projects on the conceptual framework, revenue recognition, liabilities and equity, financial instruments, and financial statement presentation? Are certain projects precedential?

AIA addressed this question in its response to the IASB and believe that response is suitable here: both the FASB and the IASB should make significant progress on fundamental projects, such as the conceptual framework and revenue recognition, in order to provide solid foundation for a global insurance accounting standard. Critical definitions, such as that for assets and liabilities, and important concepts, such as realization and the earnings process, are being reviewed and undergoing change. It would be a logical progression and certainly more efficient to set a stronger foundation for an accounting standard on insurance contracts by ensuring that these critical projects are sufficiently advanced.
November 16, 2007

Peter Clark, Project Manager
International Accounting Standards Board (IASB)
1st Floor, 30 Cannon Street
London EC4M 6XH
United Kingdom
Sent via e-mail to: commentletters@iasb.org

Re: Response to IASB Discussion Paper, Preliminary Views on Insurance Contracts

Dear Mr. Clark:

The American Insurance Association (AIA) appreciates the opportunity to respond to the IASB’s Discussion Paper, Preliminary Views on Insurance Contracts. AIA is a leading property & casualty insurance trade association, representing approximately 400 insurers that collectively write more than $120 billion in premiums each year. AIA member companies offer all types of property & casualty insurance, including personal and commercial auto insurance, commercial property and liability coverage, workers’ compensation, homeowners’ insurance, medical malpractice coverage, and product liability insurance. We respect the Board’s efforts to develop a single global insurance accounting standard and hope our comments will help move this project in the right direction.

As globalization continues, it is important for investors that similar accounting and reporting be applied to contracts that have similar economic characteristics. AIA believes a suitable accounting standard for insurance contracts must reflect the economic, legal and business reality of the transaction. We also believe it is of the utmost importance to not portray dissimilar contracts as being similar. AIA believes that in attempting to account for insurance contracts as financial instruments, the Discussion Paper incorporates elements of finance theory that might work well for assets (and derivative liabilities), but calls into question both reliability and relevance in its application to insurance liabilities.

As an organization that represents the property & casualty insurance industry, AIA is also concerned with statements and conclusions in the Discussion Paper that fail to recognize important distinctions between property & casualty contracts and life contracts. For example, payments under life contracts are generally known and are generally certain; however, property & casualty claims only arise if there is a loss event. The amount and timing of the claim payments, if any, may remain uncertain for a considerable period of time. Property & casualty contracts, such as surety or workers’ compensation contracts, may also contain service elements.

AIA represents both North American and European based property & casualty insurance enterprises and it was expected that we would have significant differences in views as we discussed the Discussion Paper. During our review of the Discussion Paper, however, we found consensus on most of the significant issues. Most importantly, AIA members agree that the model proposed by this Discussion Paper would not be relevant to users of the financial statements because it is based upon a hypothetical transaction (i.e., a transfer value notion) that cannot occur and therefore would not be reflected in future cash flows. We believe that the only
relevant measure of property & casualty liabilities is based on a "value in use" notion (i.e., an orderly settlement with policyholders), as this reflects an insurer's expectations of future net cash outflows.

Conceptually, we agree that the time value of money and uncertainty should be reflected in the measurement of the post-claim liability when the risk margin and underlying cash flows can be reliably estimated and the information is relevant to the users of the financial statements. However, as countries have different legal and regulatory environments, we expect that contracts that may appear similar will actually exhibit different economic characteristics, leading to varying measurements of claim liabilities. An accounting standard should not seek to avoid varying results; instead, it should be sufficiently flexible to reflect differences among different companies, and the business and legal environment in which they conduct their business. Indeed, it is the differences among insurers -- many arising because of individual business strategies and cost structures unique to each insurer -- that are useful to financial statement users.

Some types of property & casualty insurance claim liabilities are subject to such significant uncertainty that insurers are unable to adequately estimate the timing of the cash flows, their associated probabilities and the applicable risk margins. For these contracts, we believe that liabilities should be valued at management's best estimate of undiscounted cash flows. Any other measurement for these liabilities would imply a greater level of precision in the measurement than what actually exists.

We believe that an appropriate insurance accounting standard should incorporate the following principles:

- Reflect the legal and business environment of the insurance model, as well as the law of large numbers, the effects of diversification, and the management of claims on a portfolio basis.
- Apply a measurement objective that reflects how property & casualty insurance contracts are actually settled, instead of a measurement objective that is based on a hypothetical transfer notion that generally cannot take place.
- Provide a clear definition of insurance contracts and the scope of the guidance.
- Measure pre-claim liabilities using the unearned premium reserve.
- Use entity specific cash flows to value post-claim liabilities when relevant industry data (e.g., claim costs published by the Insurance Services Organization) is unavailable.
- Recognize revenue as earned and not at the inception of insurance contracts.
- Allow for the preparation of understandable, comparable and consistent financial statements that provide decision useful information to users in a cost-effective manner.

Throughout our response, we point out areas where the discussion paper fails to address or properly reflect significant characteristics of property & casualty contracts.

A. The Fundamentals of the Insurance Business
AIA believes an insurance accounting standard should reflect the nature and business of insurance. An initial review of the legal and business environment from which insurance contracts arise would provide crucial guidance to the Board in developing a suitable accounting standard for insurance contracts. Without making any distinction for property & casualty contracts, the Discussion Paper appears to proceed under the assumption that all insurance contracts are merely a form of investment contracts [for example, paragraph 4 (d), comparing practices of insurers to the practices of other financial institutions, such as banks and fund managers; paragraph 18(d), generalizing that insurance contracts can be viewed as containing investment or deposit components]. Such an assumption unnecessarily precludes the Board from considering important distinguishing elements of property & casualty insurance contracts from both investment contracts and other types of insurance contracts.

We believe that a fatal flaw of the Discussion Paper is that it often assumes away essential elements of insurance contracts. The basic business model of insurance involves the pooling of individual contract risks and spreading the estimated cost of those risks to all policyholders within their respective risk pools. Insurers are able to do this because of the “Law of Large Numbers,” a fundamental concept that allows insurers to effectively manage the price and cost of their risk portfolios. This concept acknowledges that the probability of any possible event (even an unlikely one) occurring at least once in a series will increase as the number of events in the series also increases. In particular, it permits a more precise measurement, as the population grows, of the likelihood that an estimate is more reflective of the actual outcome.

From a property & casualty insurer’s perspective, the odds that a specific insurance contract will result in a loss claim is low; but there is a greater probability that there will be a loss claim as the portfolio of insurance contracts grows larger. This principle can be extrapolated to allow insurers to draw conclusions or make forecasts regarding a portfolio of risks that otherwise would be impossible to do at the contract level.

A large portfolio of risks allows an insurer to estimate the cost of the claims for that portfolio and extrapolate a premium level sufficient to cover the estimated cost. Thus, the estimated cost of future claims is effectively spread to the policyholders of the particular portfolio through the premiums charged to all the policyholders. The pooling and spreading of risk – which are not just important functions, but are fundamental characteristics of the insurance business model – is not adequately addressed or incorporated into the Discussion Paper.

---

1 The Law of Large Numbers: The theory of probability on which the business of insurance is based. Simply put, this mathematical premise says that the larger the group of units insured, such as sport-utility vehicles, the more accurate the predictions of loss will be. The Insurance Information Institute. http://www.iii.org/individuals/glossary/alfa.L/
B. Areas of Concerns

Lack of Observable Market and Transfer to Hypothetical Third Party Assumptions

A suitable accounting standard for insurance contracts should not be premised upon a hypothetical transfer to a third party because that concept lacks relevance under the IASB's conceptual framework. It lacks predictive value because it extrapolates a value that, absent a random chance, would never result in future cash flows for settling the claim liability with the policyholder or third party. It lacks confirming value in that the market risk margin assumption can never be tested since it cannot be calibrated to observable market information, thus depriving an insurer of necessary feedback to refine the assumption. In addition, the analysis and modeling under the Discussion Paper approach would require a time commitment that cannot be effectively integrated into a quarterly financial reporting cycle; the cost to do so would be prohibitive.

The measurement objective of the proposed current exit value (CEV), to transfer insurance liabilities to a hypothetical third-party at each reporting date, is not consistent with the business reality of insurance. As the IASB has acknowledged, the transfers of insurance liabilities is generally prohibited due to legal and regulatory constraints. Even without these constraints, the transfer notion is not appropriate for insurance contracts due to the absence of observable markets to calibrate assumptions. We believe that the inability to calibrate "market value assumptions" calls into the question the reliability of the proposed model. Thus, the hypothetical third party transfer notion is neither relevant nor reliable for users of financial statements. Accordingly, the relevance of a CEV for property & casualty insurance liabilities is likewise doubtful.

A measurement that is based upon expected settlement of the contract liability, rather than a hypothetical transfer notion, is the appropriate measurement objective as it better reflects the economic outcome of an insurance contract and is more predictive of future cash flows. AIA members encourage the IASB to spend more time and resources on an appropriate measurement objective that reflects a value in settlement with a portfolio of policyholders' risk exposures. This approach should make use of entity specific cash flows rather than hypothetical third-party cash flows.

Discounting, Risk Margins, Gain at Inception and Portfolio Diversification

As previously stated, AIA conceptually agrees that the measurement of property & casualty post-claim liabilities should reflect the time value of money when the risk margin and underlying cash flows can be reliably estimated and the resulting measurement is decision useful for investors. We believe, however, that there are many types of post-claim liabilities, particularly in the U.S. market, where the insurer is unable to reliably estimate the post-claim liabilities due to the significant uncertainty of the risk margin and/or the underlying cash flows. In such cases, the insurer should neither discount nor apply a risk margin. AIA believes that it is inappropriate to simply discount these liabilities, in that doing so would result in a liability measurement that would not be sufficient or predictive of the future cash outflows. In these instances, AIA believes that management's best estimate of cash flows provides the appropriate measurement of the liabilities.

AIA does not believe that an insurer should record a gain at the inception of the insurance contract because: (i) there has not been an economic event that entitles the insurer to all of the contract cash inflows (e.g., the policyholder may cancel the contract at any time) and (ii) the
insurer does not have the ability to measure the profitability of a single insurance contract because the measurement of liabilities is performed at a portfolio unit of account. We believe that in order for revenue to be recorded, the insurer should provide performance under the contract. Recognition of any gain derived from the difference between the hypothetical transfer value and premium charged would be inappropriate since that hypothetical gain would never be realized in future cash flows. AIA believes the observed risk margin that is included in the premium provides the best objective evidence of a risk margin and should be used at the inception of the contract.

The Discussion Paper suggests that a risk margin should be developed for a portfolio of similar risks, but should not reflect the benefits of diversification or negative correlation across portfolios. These assumptions are inconsistent with a business model that is premised upon the "Law of Large Numbers". The purpose of pooling and spreading of risks is to take advantage of diversification, in order to estimate and manage risk. In this regard, the Discussion Paper assumptions are flawed because they assume away the essential characteristics of the insurance business model.

**Critical Foundational Projects including Revenue Recognition, Conceptual Framework, and Financial Statement Presentation Joint Projects**

The IASB should make significant progress on fundamental projects, such as the conceptual framework and revenue recognition, in order to provide solid bases for the conclusions reached in the Discussion Paper. Critical definitions, such as that of assets and liabilities, are changing and the concepts of realization and the earnings process are still being addressed. Clearly, it would be logical and more efficient for the IASB to set a stronger foundation for the Discussion Paper on insurance contracts by ensuring that the critical projects are significantly advanced.

**Recognition/De-recognition of Insurance Contracts**

The Discussion Paper assumes that an insurance contract is just like any other financial instrument and therefore concludes that an insurance liability should be recognized when the insurer becomes a party to the insurance contract. The Discussion Paper fails to elucidate what it intends with the language "becomes a party to the contract." That language is not particularly helpful. AIA believes that an insurance contract should be recognized "at the effective date" of the contract, as legally construed in the relevant jurisdiction. Premiums received by an insurer before the effective date are cash advances that typically can be returned to the policyholder or increased if further underwriting reveals higher risk than expected.

Additionally, AIA is unsure of the Board's intent as to how the IAS 39 recognition would be applied to insurance contracts since it appears to us that paragraph AG35b of IAS 39 is a more reflective criteria for the recognition of insurance contracts than the "becomes a party to the contract" requirement. Since the insurer has a conditional obligation prior to the coverage period, AG35b requires performance under the contract only after one party has completed some performance. We believe the Board will have to reconsider the recognition requirements for the Exposure Draft since it appears that simply referring preparers to IAS 39 might lead to inconsistent recognition in practice.

Certainly there should be some type of accounting recognition if an economic exchange occurs at the inception of the contract; the payment of the premium in exchange for stand-by protection is an economic exchange of value and should be recognized. However, entering into a contract – or becoming a party to the contract – is not the ultimate goal of the insurance business; the ultimate goal, particularly for the property & casualty insurance industry, is to establish a
An international accounting standard for insurance contracts needs to acknowledge the business and legal environment that applies to insurance contracts, versus the environment that applies to financial instruments. In the United States, for example, the laws that govern insurance contracts are completely different and separate from the laws governing financial instruments. Unless the liability is based on a claims-made policy, insurers operating in the United States will always be uncertain as to whether insurance liabilities are fully extinguished. Unlike investment contracts and many life insurance contracts, the insurer does not know when the liability will be extinguished since there is no expiration, cancellation or discharge of the liability. For property & casualty contracts, de-recognition is a question of when the insurer believes it is unlikely it will pay further claims. AIA suggests that it would be more appropriate to base a de-recognition standard for property & casualty insurance liabilities on the probability that only a negligible amount of liability remains.

**Measurement Objective.**

The Discussion Paper's building block approach to insurance liabilities generated the most discussion among AIA member companies. Conceptually, AIA agrees that the analysis of insurance cash flows should reflect the time value of money; however, AIA is not convinced that discounting and risk margins should apply when cash flows cannot be reliably determined or when it is not relevant to the financial statement user (e.g., short-tail liabilities).

AIA has identified other issues which render the building block approach unworkable. If the Board wishes to continue with the building block approach, it must address these issues:

- Because there could be an infinite number of cash flow projections for Building Block #1, we believe the estimate of insurance liabilities should be based on reasonably possible cash flows. The language used in the Discussion Paper is ambiguous and the Board should clarify its meaning.

- Since the Discussion Paper operates on the assumption that insurance contracts are comparable to financial instruments that trade in deeply liquid markets (assumptions that are inconsistent with the economic reality of insurance contract liabilities), the Discussion Paper assumes that transfer value is the most relevant value. Transfer value is clearly relevant for instruments that can be transferred; however, as acknowledged in the Discussion Paper, insurance liabilities can only be settled, not transferred. As currently drafted, the Discussion Paper does not provide a compelling argument as to why transfer value would be relevant for contracts that cannot be transferred. The Board
must explain and justify why any value other than settlement value should be the preferred standard for insurance contracts.

- What is the best estimate of cash flows? Even though U.S. generally accepted accounting principles require a single best estimate, in practice there are a variety of actuarial approaches for determining best estimates, and some of those approaches already have probability weighting embedded in the underlying formulas. Additionally, a market-consistent and unbiased estimate will require significant judgment, and therefore will be subjective. Therefore, how is usefulness enhanced by replacing the existing system with a system involving more layers of uncertainty?

- As a practical matter, the Discussion Paper’s approach may not work for property & casualty contracts. In theory, individual contract cash flows should add up to the whole if everything were independent. However, this approach does not reflect the reality of how property & casualty claim liabilities are managed because decisions for one claim may significantly affect other claim payments. For example, an insurer may decide to settle a claim brought in an unfavorable jurisdiction, rather than litigating it and allowing an adverse decision to become precedent for other claims. Therefore, an insurer may be willing to pay more on one claim in order to save on other claims because claim settlement decisions are not made in isolation.

Another flaw with the Discussion Paper is that it does not provide sufficient information about the unit of measurement: is it the contract, the portfolio or the entity? Even if one were to agree with the building blocks, the measurement objective is still at issue and needs to be clarified by the Board. Further, AIA believes the Board will have to consider what is meant by the term “portfolio”, since property & casualty insurers tend to reserve by a portfolio of similar exposures and not necessarily by a portfolio of contracts.

AIA is concerned about using a market consistent approach rather than looking at how the company manages the business and settles its liabilities. A market consistent value for property & casualty liabilities is not observable and, therefore, cannot be practically applied. For discussion purposes, we believe it is acceptable for the Discussion Paper to lay out a theoretical approach, as long as practical considerations are also included.

C. Other Concerns

AIA is concerned that the Discussion Paper focuses too much on life insurance and lacks adequate discussion of property & casualty insurance contracts. To complete a comprehensive insurance standard, it is important that the Board have a full understanding of the economic characteristics of the various types of property & casualty insurance contracts, as well as how the different systems of jurisprudence affect risk management and an insurer’s ability to adequately estimate the underlying cash flows. AIA is willing to provide educational information to the Board about the varied and often unique characteristics of property & casualty insurance products.

AIA is concerned with the lack of deliberations on performance measurement prior to the issuance of the Discussion Paper. We believe that it is possible to build a theoretically correct model that is irrelevant to the financial statement users. Instead of going down that road, we believe that performance measurement should be fully deliberated prior to issuance of an insurance contracts exposure draft. For example, the model in the Discussion Paper would
essentially eliminate all of the current metrics used by property & casualty insurers to convey the performance of their business. Generally, these metrics are well understood by the property & casualty user community who, as we understand, are not calling for a significant change in property & casualty performance metrics.

We are very troubled by the prospect that the model in the Discussion Paper would lead insurers to report results in a manner that is significantly different from how insurers manage their risk and evaluate their performance. For SEC filers, the Discussion Paper could lead to the use of two sets of metrics in Management’s Discussion and Analysis: (i) a discussion based upon changes in line items in financial statements (i.e., the Discussion Paper metrics) and (ii) a discussion based upon how management evaluates its performance (i.e., current metrics).

Additionally, AIA is concerned that implicit in the model discussed in the Discussion Paper is a performance measurement component arising from a “market consistent” predisposition. We note, however, that if a company has a different expense structure or claims handling process than its competitors, the model should reflect the differences in the liability measurement, which is an implicit form of performance reporting. Under the Discussion Paper approach, however, efficient insurers would report higher expenses than their actual expectations and inefficient insurers would be rewarded with the ability to report lower expenses. AIA requests the Board to re-think this implicit performance reporting and whether these contrary results are really intended.

We are troubled by the concept of a service margin. The Discussion Paper lacks discussion of the products that have the most significant service component, particularly property & casualty contracts where the insurer has a “duty to defend” and may be required to “step into the shoes” of the insured. We believe the service margin concept should, at a minimum, be re-evaluated.

Although we believe that the Board’s views in the Discussion Paper have not been influenced by Solvency II, we are aware of the pressure within the European community to have significantly converged regulatory and general purpose accounting standards. As the final standard will be a global standard, and not solely a European accounting standard, AIA requests that the Board continue to act independently of the Solvency II process. We are not convinced that there is a need to have converged regulatory and general purpose accounting standards and are more concerned with having accounting standards that are appropriate for their use.

We would be happy to discuss our comments with you at your convenience and participate in any roundtables or other forums the Board may hold.

Please see Appendix A below for AIA’s responses to the questions raised in the Discussion Paper.

Sincerely,

Phillip L. Carson
Assistant General Counsel
Appendix A: Responses to Discussion Paper Questions

Question 1.

Should the recognition and de-recognition requirements for insurance contracts be consistent with those in IAS 39 for financial instruments? Why or why not?

This question suggests a predisposition for treating insurance contracts as IAS 39 instruments. There are many different types of insurance products, some of which may fall within the scope of IAS 39. However, IAS 39 should not be the starting point for guidance on recognizing or de-recoginizing insurance liabilities. Therefore, it is not necessary to force a linkage between IAS 39 instruments and insurance contracts.

As discussed in our summary, we do not believe that the recognition and de-recognition requirements of IAS 39 work well for property & casualty contracts. It appears that the IAS 39 requirements could lead one to believe that recognition would be determined based on a service concept as outlined in AG35, which we agree with; however, this determination appears to be contrary to the “party to the contract” language in paragraph 27 of the Discussion Paper. Additionally, we are confused as to the intent of paragraph 27 of the Discussion Paper, which appears to include two competing thoughts with one being the aforementioned “party to the contract” language and the other which states that recognition is based on “when the entity becomes a party to the contractual provisions of the instrument”.

AIA believes that IAS 39 does not contemplate the unique features of property & casualty insurance contracts when it comes to de-recognition. For property & casualty contracts, and particularly in the U.S. market, there are no contractual provisions that allow an insurer to conclusively know when the liability is extinguished, outside of claims-made policies. There are three factors affecting extinguishment of insurance liabilities: (1) claims can be presented well after the exposure period, (2) claims thought to be settled can be re-opened and (3) the terms of the coverage can be expanded through litigation. These factors create an environment where the insurer can never precisely know if a liability is extinguished; it only knows when it believes the chance of loss becomes negligible.

AIA believes that the insurance standard will have to recognize that property & casualty liabilities have unique characteristics in order to adequately account for the economics of the liabilities.

Question 2.

Should an insurer measure all its insurance liabilities using the following three building blocks:

(a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows,

(b) current market discount rates that adjust the estimated future cash flows for the time value of money, and
(c) an explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin)?

If not, what approach do you propose and why?

2 (a). AIA believes that insurers should use entity specific cash flows in valuing insurance liabilities. Estimated market consistent cash flows do not reflect the efficiencies and synergies of an insurer and would generally be subject to significant subjectivity and judgments that would impede comparability across insurers. The use of a best estimate or probability weighted approaches should be left to the judgment of competent actuaries. Nonetheless, the term “probability weighted” should not be interpreted to mean full blown stochastic modeling, which simply is not practicable and presumes some precision which does not exist. Importantly, insurance liabilities typically incorporate “tail risks” for which stochastic modeling is not an appropriate approach. We believe that the IASB should specify a sound measurement objective with suggested methods and allow competent actuaries to develop a computational approach that is appropriate for a portfolio.

2 (b). AIA believes that the appropriate discount rate for non-life insurance liabilities with reliably determinable cash flows and risk margin should be the current risk-free rate. AIA believes that it is more appropriate to use the best estimate or mean cash flows instead of discounted probability weighted estimates in the case of non-life liabilities with short payout periods (e.g., most auto physical damage and homeowners’ property insurance).

2 (c). AIA believes that where insurance liabilities are appropriately discounted, an insurer should include risk margins (and any service margins, if applicable; however, as previously noted, the Discussion Paper lacks sufficient explanation of service margins). The risk margin at inception of the insurance contract should be the observed risk margin in the premium charged, not a hypothetical market participant risk margin.

AIA proposes that:

- Unearned premium reserves should be used to measure pre-claim liabilities.
- A present value settlement approach should be used to measure post-claim liabilities (e.g., best estimate or probability weighted estimate of entity specific cash flows) when both the timing and amount of cash flows can be reliably determined. When the timing and amount of cash flows cannot be reliably determined, the best estimate of claim liabilities should be used.

**Question 3.** Is the draft guidance on cash flows (appendix E) and risk margins (appendix F) at the right level of detail? Should any of that guidance be modified, deleted or extended? Why or why not?

AIA believes that appendices E and F are too detailed for a principles-based accounting standard. The IASB should specify the overall principle that the cash flows included in pricing should be included in the measurement of the liability (appendix E) and that at the inception of the insurance contract, the risk margin should be calibrated to the premium charged so that there is no gain/loss. Over time, the International Actuarial Association, or its equivalent, should provide further detailed guidance, as appropriate, on the issues raised in Appendices E and F.
Appendix E, Estimate of Future Cash Flows, raises more questions than it answers. The requirement for “market-consistent” estimates is problematic because there is no market available. The appendix does not provide clarifying examples.

It is not clear how market consistent cash flow estimates would be decision-useful to insurers, investors, analysts and other users since it would be very subjective. The relative efficiencies and synergies of an insurer are germane to its ability to settle policyholder claims as they become due.

Although AIA members expressed varying levels of skepticism about the guidance in Appendix E, they all agreed that it would be very difficult to apply the building block approach to valuing insurance liabilities. In addition, this appendix presents too many elements that are not relevant to settlement value, which AIA believes is the only useful value with respect to insurance liabilities.

Appendix F guidance demonstrates that the role of the risk margin remains confusing and unclear. It provides little information on how risk margins should be calibrated to the underlying risk. The Discussion Paper fails to demonstrate the utility of risk margins to financial statement users.

Question 4.

What role should the actual premium charged by the insurer play in the calibration of margins, and why? Please say which of the following alternatives you support.

(a) The insurer should calibrate the margin directly to the actual premium (less relevant acquisition costs), subject to a liability adequacy test. As a result, an insurer should never recognize a profit at the inception of an insurance contract.

(b) There should be a rebuttable presumption that the margin implied by the actual premium (less relevant acquisition costs) is consistent with the margin that market participants require. If you prefer this approach, what evidence should be needed to rebut the presumption?

(c) The premium (less relevant acquisition costs) may provide evidence of the margin that market participants would require, but has no higher status than other possible evidence. In most cases, insurance contracts are expected to provide a margin consistent with the requirements of market participants. Therefore, if a significant profit or loss appears to arise at inception, further investigation is needed. Nevertheless, if the insurer concludes, after further investigation, that the estimated market price for risk and service differs from the price implied by the premiums that it charges, the insurer would recognize a profit or loss at inception.

(d) Other (please specify).

Answer: (a). Where applicable, AIA believes that an insurer should calibrate the risk margin directly to the actual premium charged (less acquisition costs) and be subject to a liability adequacy test. In this regard, option (a) provides a better measure of risk margins than options (b) and (c) because the actual premium is an observed market transaction. We do not believe
Question 5. The paper proposes that the measurement attribute for insurance liabilities should be the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity. The paper labels that measurement attribute “current exit value’.

(a) Is that measurement attribute appropriate for insurance liabilities? Why or why not? If not, which measurement attribute do you favour, and why?

As defined by the Discussion Paper, current exit value is premised on a hypothetical transfer that could never take place. AIA believes an impractical hypothetical should not form the basis of an accounting standard for insurance. We believe the only relevant measurement attribute is settlement value.

(b) Is “current exit value’ the best label for the measurement attribute? Why or why not?

Current exit value is an inappropriate description for a measurement objective that transfers insurance liabilities to a hypothetical third-party. AIA would label it a “hypothetical transfer price.”

Question 6. In this paper, beneficial policyholder behaviour refers to a policyholder’s exercise of a contractual option in a way that generates net economic benefits for the insurer. For expected future cash flows resulting from beneficial policyholder behaviour, should an insurer:

(a) incorporate them in the current exit value of a separately recognized customer relationship asset? Why or why not?

(b) incorporate them, as a reduction, in the current exit value of insurance liabilities? Why or why not?

(c) not recognize them? Why or why not?

No Comment – AIA believes this is a topic more relevant to life insurers.

Question 7. A list follows of possible criteria to determine which cash flows an insurer should recognise relating to beneficial policyholder behaviour. Which criterion should the Board adopt, and why?

(a) Cash flows resulting from payments that policyholders must make to retain a right to guaranteed insurability (less additional benefit payments that result from those premiums). The Board favours this criterion, and defines guaranteed insurability as a right that permits continued coverage without reconfirmation of the policyholder’s risk profile and at a price that is contractually constrained.
(b) All cash flows that arise from existing contracts, regardless of whether the insurer can enforce those cash flows. If you favour this criterion, how would you distinguish existing contracts from new contracts?

(c) All cash flows that arise from those terms of existing contracts that have commercial substance (i.e. have a discernible effect on the economics of the contract by significantly modifying the risk, amount or timing of the cash flows).

(d) Cash flows resulting from payments that policyholders must make to retain a right to any guarantee that compels the insurer to stand ready, at a price that is contractually constrained, (i) to bear insurance risk of financial risk, or (ii) to provide other services. This criterion relates to all contractual guarantees, whereas the criterion described in (a) relates only to insurance risk.

(e) No cash flows that result from beneficial policyholder behaviour.

(f) Other (please specify).

No Comment – AIA believes this is a topic more relevant to life insurers.

**Question 8. Should an insurer recognize acquisition costs as an expense when incurred? Why or why not?**

AIA believes that consistent treatment of the acquisition costs and the pre-claim liability (unearned premium reserve) is a greater concern than whether acquisition costs are expensed. If the acquisition costs are expensed as discussed in the Discussion Paper, then the pre-claim liability should be reported net of the acquisition costs. If the pre-claim liability is reported gross, then the acquisition costs should be reported as a pre-paid asset.

Although our preference is for consistent treatment of acquisition costs and pre-claim liability, AIA believes that there are future economic benefits associated with certain acquisition expenses. For example, in reinsurance, portfolio transfers and business combinations, insurers typically receive reimbursement for acquisition expenses in the form of ceding commissions or as part of the transfer/purchase price. Additionally, for cancellable property & casualty contracts, the insurer receives a pro rata refund of the applicable commissions and premium tax upon cancellation by the policyholder.

**Question 9. Do you have any comments on the treatment of insurance contracts acquired in a business combination or portfolio transfer?**

AIA believes that it is important that the various standards covering insurance contracts allow insurers to treat insurance liabilities consistently. We recognize that in a business combination or portfolio transfer, the purchaser has actual market information to calibrate the insurance liability fair values, and fair value is the appropriate measure. Since we do not believe fair value for insurance liabilities is appropriate outside of these constructs and we want consistent treatment, we believe that the fair value adjustment in a business combination or portfolio transfer should be reported separately from the insurance liabilities. In separating the fair value adjustment, insurers are able to consistently account for the purchased contracts with their pre-
existing contracts, and are therefore able to achieve some of the desired efficiencies of the transaction.

**Question 10.** Do you have any comments on the measurement of assets held to back insurance liabilities?

No comment. AIA has limited its responses to property and casualty insurance issues. This question addresses the issue of avoiding accounting mismatches, which is predominantly a life insurance industry issue.

**Question 11.** Should risk margins:

a) Be determined for a portfolio of insurance contracts? Why or why not?
   If yes, should the portfolio be defined as in IFRS 4 (a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio). Why or why not?

b) Reflect the benefits of diversification between (and negative correlation between) portfolios? Why or why not?

11 (a). Risk margins for the pre-claim liability should be determined on a portfolio basis for the pre-claim liability in a manner that is consistent with how the insurer manages and prices its risk exposures, and should include the benefits of diversification that would be reflected in the premium charged. U.S. property & casualty insurers manage liabilities on the basis of a portfolio of similar exposures. Many U.S. contracts have different risk exposures and when determining liabilities, it is more appropriate to reserve by portfolio of risk exposures across contracts. However, the definition of "portfolio" in IFRS 4 is not workable and should be expanded to reflect benefits of diversification and negative correlation. We recommend changing the term "contracts" to "coverages" to be more representative of actual reserving practices.

11 (b.) A basic premise of insurance is the pooling of risks transferred by individual contracts. Pricing of contracts is based on a portfolio approach, which assumes individual contracts will be part of a portfolio, and that portfolios are part of a larger aggregation that diversifies the risks assumed by the insurance company. Excluding the effects of diversification among portfolios in the risk margin could overstate liabilities, resulting in loss recognition at contract inception. Additionally, the service component of the risk margin, as contemplated by the Discussion Paper, would not reflect differences in cost structures and cost efficiencies of different companies.

The IASB views CEV as being independent of the entity that holds the assets or liabilities. The Discussion Paper relies on market consistent factors rather than company specific factors, which leads to the conclusion that risk margins should be determined for each portfolio in isolation and should not consider diversification or negative correlation between portfolios. However, AIA believes that risk margins should be determined for a portfolio of risk exposures and that risk margins should reflect diversification and negative correlations between portfolios. Risk margins for an individual contract would differ from the risk margin for a portfolio of contracts.
**Question 12.**

a) Should a cedant measure reinsurance assets at current exit value? Why or why not?

b) Do you agree the consequences of measuring reinsurance assets at current exit value include the following? Why or why not?
   (i) a risk margin typically increases the measurement of the reinsurance asset, and equals the risk margin for the corresponding part of the underlying insurance contract. No
   (ii) an expected loss model would be used for defaults and disputes, not the incurred loss model required by IFRS 4 and IAS 39.
   (iii) if the cedant has a contractual right to obtain reinsurance for contracts that it has not yet issued, the current exit value of the cedant's reinsurance asset includes the current exit value of that right. However, the current exit value of that contractual right is not likely to be material if it relates to insurance contracts that will be priced at current exit value.

In responding to the question of whether a cedant should measure reinsurance assets at CEV, it makes sense to use a similar approach for measuring the reinsurer's assets. However, applying the Discussion Paper concepts raises similar issues to those discussed above in question number 11. The CEV approach in the Discussion Paper does not work in all cases of reinsurance. The Discussion Paper implies risk margins and credit risk would be the same for the reinsurer and the primary insurer. However, this is not necessarily the case. Reinsurance contracts are not symmetrical with the primary insurance contracts, so risks will differ. Determining risk margin for direct insurers without considering reinsurance is not what a 3rd party would pay if buying a whole book of business subject to an existing reinsurance program.

In response to question 12 (b) on the consequences of measuring reinsurance assets at current exit value:

(i) For quota share reinsurance, AIA believes the risk margin of the reinsurance asset would equal the risk margin for the corresponding part of the underlying contract. For example, in a pure quota share reinsurance agreement and excluding credit risk, one would have the same risk margin and the reinsurance asset would equal the reinsurance liability. For an excess-of-loss contract, however, the underlying contracts must be aggregated in order to trigger the excess-of-loss coverage. Because the contracts must be aggregated, there is no corresponding part of the underlying contract. And therefore, there can be no equality of risk margins. For an excess-of-loss contract, the risk margin needs to be measured with respect to the cash flows that would trigger a recovery under the excess-of-loss contract.

A remaining issue: if the reinsurance risk margin increases the value of reinsurance assets, how should this increase be handled on the cedant's side? Would the cedant increase the reinsurance recoverable?

(ii) AIA believes that the expected loss model for defaults and disputes would be appropriate.

(iii) AIA believes the right to obtain reinsurance on contracts not yet issued is an economic benefit. However, a reinsurance asset should not be recognized until the underlying contract is issued.
Question 13. If an insurance contract contains deposit or service components, should an insurer unbundle them? Why or why not?

AlA opposes unbundling of deposit or service components. The effort to unbundle insurance contracts would lead to the application of inconsistent bifurcation methods among insurance companies and therefore lead to data that is neither reliable nor understandable. The AlA previously commented to the FASB on the idea of unbundling and we reiterate our concerns below:

- It is difficult to see how breaking down this contract into deposit or insurance components would provide decision-useful information. In the property & casualty insurance industry, the policyholder is not entitled to a return of the earned portion of the premium payment, which the term deposit might suggest. The fact that the premium is not returned is more consistent with a pooling and spreading scenario.

- It is unclear what purpose would be served by unbundling the contract and re-characterizing the elements of the contract. The re-characterization only begs the question of how the “deposit” amount should be accounted for and reported by the insurer and the policyholder if there is no loss event. When would the property & casualty insurer recognize it as income? Would it be forfeited deposit expense for the policyholder? And if so, why would that awkward characterization be more relevant than calling it insurance expense? Unbundling in this case would be an unnecessary complication added to the financial statements, without providing an incremental value to users of the financial statements.

- Assuming a contract has been unbundled, subsequent claim payments raise issues regarding the allocation of the payment: should it be applied against the deposit amount or treated as an insurance recovery? The possible arbitrary nature of the allocation will call into question the qualitative characteristic of reliability because of the lack of verifiability.

- The administrative costs resulting from a requirement to bifurcate (i.e., unbundle) reinsurance contracts would outweigh the benefits. The effort related to evaluating all contracts for bifurcation would be enormous. The ongoing accounting for contracts that require bifurcation would also be considerable. From the insurer’s perspective, much time, cost and effort must be invested to unbundle the contract at inception and for the processing of claims payments. AlA sees no sufficient benefit to justify the additional cost, which would be substantial because of the many systems changes that would be required. The total obligation to policyholders would not change, so we believe the additional information would not be meaningful.

Question 14.

a) Is the current exit value of a liability the price for a transfer that neither improves nor impairs its credit characteristics? Why or why not?

b) Should the measurement of an insurance liability reflect (i) its credit characteristics at inception and (ii) subsequent changes in their effect? Why or why not?
The Discussion Paper's position is that CEV of insurance liabilities should reflect the liability's credit characteristics. AIA disagrees. In financial theory, this concept makes sense and works with financial instruments. However, there is no practical application to insurance liabilities; nor is there body of work available to show how it can be done in practice.

Take, for example, a debt instrument, such as a bond -- the market value of the bond will decline as the creditworthiness of the issuer declines. The issuer can enter the market in which that bond trades and re-acquire it at the lower value, and effectively extinguish its liability at an amount less than it nominally owes. However, at least in the U.S., no such trading facility exists for insurance liabilities, so insurers would not be able to reduce their liabilities as their own creditworthiness declines. Plus, regulatory constraints would prevent such an attempt, even if there were a market facility available for reducing insurance liabilities.

Applying the Discussion Paper theory to insurance, an insurance company with poor credit would have lower liabilities than an insurance company with good credit – an illogical result. It should also be pointed out that such a result does not accurately reflect the fact that the U.S. insurance regulatory framework includes a guaranty fund system. Thus, the declining credit risk of the company would not affect the value of the liabilities, unless the guaranty fund went bankrupt.

**Question 15.** Appendix B identifies some inconsistencies between the proposed treatment of insurance liabilities and the existing treatment under IAS 39 of financial liabilities. Should the board consider changing the treatment of some or all financial liabilities to avoid those inconsistencies? If so, what changes should the board consider, and why?

No comment. We believe that it is appropriate to have inconsistencies between the accounting for financial instruments and the accounting for property & casualty insurance contracts due to the differences between the types of contracts as previously discussed.

**Question 16.**

(a) For participating contracts, should the cash flows for each scenario incorporate an unbiased estimate of the policyholder dividends payable in that scenario to satisfy a legal or constructive obligation that exists at the reporting date? Why or why not?

(b) An exposure draft of June 2005 proposed amendments to IAS 37 (see paragraphs 247-253 of this paper). Do those proposals give enough guidance for an insurer to determine when a participating contract gives rise to a legal or constructive obligation to pay policyholder dividends?

No comment. This is predominantly a life issue.

**Question 17.** Should the Board do some or all of the following to eliminate accounting mismatches that could arise for unit-linked contracts? Why or why not?
(a) Permit or require insurers to recognize treasury shares as an asset if they are held to back a unit-linked liability (even though they do not meet the Framework’s definition of an asset).

(b) Permit or require insurers to recognize internally generated goodwill of a subsidiary if the investment in that subsidiary is held to back a unit-linked liability (even though IFRS prohibit the recognition of internally generated goodwill in all other cases).

(c) Permit or require insurers to measure assets at fair value through profit or loss if they are held to back a unit-linked liability (even if IFRS do not permit that treatment for identical assets held for another person).

(d) Exclude from the current exit value of a unit-linked liability any differences between the carrying amount of the assets held to back that liability and their fair value (even though some view this as conflicting with the definition of current exit value).

No comment. This is predominantly a life issue.

**Question 18.** Should an insurer present premiums as revenue or deposits? Why?

Yes, insurers should present premiums as revenues in the income statement because premiums meet the existing and emerging definition of revenue under FASB’s Statement of Financial Accounting Concept No. 6 and the IASB’s International Accounting Standard 18.Premium should be recognized by the insurer over the coverage period as economic benefits are earned from agreeing to indemnity the policyholder for defined fortuitous losses. Providing indemnification is the central activity of an insurers’ business model. By definition, the earning of these economic benefits should be reflected as revenues.

A dramatic change, such as accounting for insurance premiums as deposits instead of revenue, is a poor idea that would create insurance company income statements that would become far less informative and far less useful in comparing both insurers to other insurers, and comparing insurers to entities in other industries. This lack of comparability would result in the need for financial statement readers to spend additional time analyzing financial statement notes in order to ascertain basic information about the company. A model that considers premiums has two significant problems:

1. Failure of the income statement to provide relevant information concerning the size/scope of an insurer’s operations and operating performance

Example 15 of Appendix G illustrates the premiums using a deposit approach, which shows the top line of the statement as “insurance margin” - effectively a company’s net margin of premiums less losses. In such a model, a large global insurer with premiums of $1 billion and $990 million of losses would report the same top-line margin amount ($10 million), as a small regional insurer with premiums of $50 million and losses of $40 million. Not only does this net margin obfuscate the relative sizes of comparative companies, it also presents a distorted picture of the operating results of the company, since clearly the latter company in this example has a much better loss ratio. In fact, without a multi-line presentation, long-accepted historical ratios such as Loss Ratio and Combined Ratio could not be determined based on a review of
Another issue with the Discussion Paper's proposed "margin approach" is that while it seems to financial reporting, in terms of bringing the presentation for these two types of arrangements more into alignment.

treat traditional insurance/reinsurance contracts of their differences from other insurance contracts. The attempts by the Discussion Paper to arrangements, for which the accounting standard-setters have gone to great lengths to create a separate deposit accounting framework under which to reflect these transactions, in recognition of their differences from other insurance contracts. The attempts by the Discussion Paper to treat traditional insurance/reinsurance contracts as deposits seems to be a step backward for financial reporting, in terms of bringing the presentation for these two types of arrangements more into alignment.

Another key argument made by the Discussion Paper in Paragraph 317 is that the current presentation of insurance premium as revenues as opposed to deposits is inconsistent with how banks treat deposits received. This is another inappropriate comparison in light of the significant differences in the significant characteristics of bank deposits versus property & casualty insurance and reinsurance contracts. A deposit received by a bank represents a definitive amount, received from the customer, and will be repaid at the conclusion of the deposit period, along with a contractually determined amount of interest. Conversely, an insurance contract does not necessarily contain static amounts in terms of the cash flows received from the customer and the amounts which may be repaid. Obviously, the cash outflows will vary significantly based on the claims experience associated with the contracts. However, there is also great variability in the net cash inflows received (e.g., under a reinsurance contract, premium receipts change as a result of retrospective premium and reinstatement premium adjustments, while amounts received under primary insurance contracts change, e.g. audit premiums.

Those contracts of insurance which do function like bank deposits are finite reinsurance arrangements, for which the accounting standard-setters have gone to great lengths to create a separate deposit accounting framework under which to reflect these transactions, in recognition of their differences from other insurance contracts. The attempts by the Discussion Paper to treat traditional insurance/reinsurance contracts as deposits seems to be a step backward for financial reporting, in terms of bringing the presentation for these two types of arrangements more into alignment.

Example 14 of Appendix G presents slightly more detail on the face of the income statement by expanding the net margin concept into three separate lines for changes in policyholders account, policyholder benefits and expenses. However, this presentation also has its shortcomings, mainly through the recognition of claims paid on the policyholder benefits line while the reserve change component of "incurred" losses are presented in the changes in policyholder account line. This seems to make the income statement more duplicative of the statement of cash flows (at least in regard to claims) than a statement of economic benefits and costs, and blurs the distinction between the two. The logic is unclear as to why both of these two basic financial statements would report the same claims paid information, yet one would have to go to the notes to the financial statements to ascertain "incurred' loss amounts, a more accurate measure of economic performance. Ironically, this same argument (i.e., cash flow information does not belong in the income statement) is actually espoused by the Discussion Paper in Paragraph 313, in order to object to companies which use a 2-line approach to income statement premium presentation (premium written on one line, change in unearned premium reserve on a second line). But then the Discussion Paper uses the same argument in a reversal of its previous position, to endorse the cash flow approach for losses in its Appendix G, Example 14.

2. Failure of the income statement to depict the nature / risk profile of a property & casualty insurance product as compared to financial instruments

Another key argument made by the Discussion Paper in Paragraph 317 is that the current presentation of insurance premium as revenues as opposed to deposits is inconsistent with how banks treat deposits received. This is another inappropriate comparison in light of the differences in the significant characteristics of bank deposits versus property & casualty insurance and reinsurance contracts. A deposit received by a bank represents a definitive amount, received from the customer, and will be repaid at the conclusion of the deposit period, along with a contractually determined amount of interest. Conversely, an insurance contract does not necessarily contain static amounts in terms of the cash flows received from the customer and the amounts which may be repaid. Obviously, the cash outflows will vary significantly based on the claims experience associated with the contracts. However, there is also great variability in the net cash inflows received (e.g., under a reinsurance contract, premium receipts change as a result of retrospective premium and reinstatement premium adjustments, while amounts received under primary insurance contracts change, e.g. audit premiums.

Those contracts of insurance which do function like bank deposits are finite reinsurance arrangements, for which the accounting standard-setters have gone to great lengths to create a separate deposit accounting framework under which to reflect these transactions, in recognition of their differences from other insurance contracts. The attempts by the Discussion Paper to treat traditional insurance/reinsurance contracts as deposits seems to be a step backward for financial reporting, in terms of bringing the presentation for these two types of arrangements more into alignment.

Another issue with the Discussion Paper's proposed "margin approach" is that while it seems to endorse a more cash-based approach to the presentation of premium and claims, and would change insurance accounting to more closely mirror accounting for financial instruments like
bank deposits, how then can the Discussion Paper ignore the income statement approach to investment income from bonds/debt instruments utilized in insurer’s income statements? Wouldn’t insurers need to then account for investment income receipts and expenses on a cash collected/paid basis, with changes in income accruals collected in a ‘change in bondholders’ account?’

**Question 19.** What items of income and expense should an insurer present separately on the face of its income statement? Why?

AIA believes that this question is premature and that whatever income and expense insurers currently present on their income statement should continue to be presented to help users to make informed decisions.

**Question 20.** Should the income statement include all income and expense arising from changes in insurance liabilities? Why or why not?

The income statement should include all items of income and expenses that arise from changes in insurance liabilities unless those changes are hypothetical in nature as under the IASB Discussion Paper proposals.

**Question 21.** Do you have other comments on this paper?

The feasibility of any potential standard should first be field tested before being exposed as a proposed accounting standard.