November 30, 2007

Technical Director – File Reference No. 1540-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

American International Group, Inc. (AIG) appreciates the opportunity to comment on the Financial Accounting Standards Board (FASB) Invitation to Comment (ITC), An FASB Agenda Proposal: Accounting for Insurance Contracts by Insurers and Policyholders, Including the IASB Discussion Paper, Preliminary Views on Insurance Contracts (DP).

AIG, a Delaware corporation, is a holding company which, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and more than 130 countries and jurisdictions. AIG's primary activities include both General Insurance and Life Insurance & Retirement Service operations. Other significant activities include Financial Services and Asset Management. AIG's common stock is listed on the New York Stock Exchange, as well as the stock exchanges in Paris and Tokyo.

We encourage the FASB to add a project to its agenda to comprehensively address the US GAAP accounting for insurance contracts. This letter provides our comments on the nature and direction of such a project, and incorporates our views on the DP as necessary, in support of our proposals. For your convenience, our answers to questions raised in the ITC, in Q&A format, are provided in Appendix A. Additionally, our letter to the IASB in response to the DP is provided in Appendix B.

AIG supports the long-term strategic priority of the FASB and IASB to work toward the convergence of U.S. and international accounting standards through the development of a common set of high-quality global accounting standards.

Early participation by the FASB in a joint insurance accounting project will be critical in ensuring that US constituents (both preparers and users of US GAAP financial statements) are actively engaged in the development of this guidance. Attempting to achieve convergence by joining this process after the IASB begins its project would likely be difficult.
Objective of the FASB project

As a multi-line insurance company involved in issuing nearly every type of insurance contract we believe that a single model for all insurance contracts is highly unlikely and impractical. There are real differences between types of contracts, differences that have caused and supported the continuation of multiple models for accounting for insurance contracts in US GAAP. We therefore remain skeptical whether a single model can appropriately address the significant economic differences among product types, particularly life contracts versus non-life contracts. Accordingly, this project must involve a critical assessment of existing US GAAP, and could very well result in the affirmation of many elements of existing GAAP.

Interaction with other projects

As the ITC points out, there are several important projects on the FASB and IASB’s joint agenda that would potentially impact, or be impacted by, a project to comprehensively address the accounting for insurance contracts, including revenue recognition, liabilities and equity, and financial statement presentation. An insurance project that does not carefully and deliberately consider these other projects could lead to unintended consequences.

One cross-over issue that could be an obstacle to the finalization of the insurance project is revenue recognition. The DP describes a proposed measurement approach for insurance contracts that it refers to as ‘current exit value’ (CEV). The DP defines this as the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity. On its face, the proposed CEV definition appears to be similar to fair value as defined in SFAS No. 157, Fair Value Measurements. However, we note that the CEV definition is not equivalent to how market participants, if they were to exist, would view these contracts. Importantly, the DP’s approach considers the insurance contract to be similar to most other financial instruments, rather than a service contract, and does not address the important question of whether, or in what circumstances, premiums received from a policyholder represent revenue.

We believe insurance contracts are not simply a collection of cash flows, particularly for non-life insurance contracts. The insurance company’s obligation to stand ready to perform represents a performance obligation, which is not typical in most other financial instruments. This makes a model based on measurements of financial instruments in general inappropriate. The performance obligation, in our view, represents a provision of services, the premiums for which represent revenue. This manner of looking at the insurance contract is similar to the concepts underlying FASB Interpretation No. 45, Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.

A need for multiple models

The DP sets out an objective to create a single model for both life and non-life insurance contracts. This objective, and the model proposed in the DP, do not adequately consider the significant
differences between life and non-life insurance. Typically, life and non-life businesses are managed and regulated separately and, as a consequence, in the US and many other countries, an insurance company is either licensed to write life or non-life contracts, but not both. This separation is driven by the fact that there are differences in the underlying risks, timing, and amount of expected cash flows between life and non-life contracts. We believe these differences should be considered in creating an accounting model applicable to these businesses, such that they may need to be subject to different models.

**Predictability of Cash Flows**

A fundamental difference between life and non-life insurance contracts (particularly long-tail casualty lines), is that the timing and amount of future cash flows associated with a portfolio of life insurance contracts can be predicted with a relatively high degree of accuracy, while the timing and amount of cash flows for non-life contracts are inherently more uncertain. In the life insurance business, historical mortality and lapse experience, both industry wide and company specific, have been demonstrated to be an accurate predictor of future cash flows. In contrast, for many long-tail casualty lines of business the timing and amount of expected loss and loss expense payments can vary significantly due to numerous factors. As a result, historical results cannot be used as an accurate predictor of future experience.

**Performance Management**

A key success factor for non-life insurers today, as viewed by both management and financial statement users, is underwriting performance, measured by comparing nominal losses and expenses incurred to premiums earned. Investment income earned on premiums received provides additional income, but has traditionally not been considered in assessing an insurer's "underwriting performance." In fact, the anticipation of investment income in the pricing of non-life contracts is a philosophy that has historically led to insurer insolvency, because the risks of underwriting outweigh the potential for investment income.

In contrast, investment income is a critical element in the pricing and underwriting-performance measurement of life insurance contracts, which are generally expected to be in force for an extended period of time. These contracts are backed by investments with durations matched to the expected durations of the insurance contracts. Investment performance is not managed separately for these contracts because it is an integral element to the pricing of a life insurance contract.

**A model for non-life insurance contracts**

While we recognize that there are some improvements that can be made, we recommend the starting point for the accounting for non-life insurance contracts be the US GAAP model in SFAS No. 60, *Accounting and Reporting by Insurance Enterprises*, applicable to short-duration insurance contracts.

We note that this model is well understood by users of financial statements and is consistent with the way management assesses and monitors this business. In fact, the US GAAP model for non-life
contracts is substantially the same as that used in many other countries with established frameworks (e.g., the UK) and in most other countries throughout the world today in the absence of a single comprehensive IASB standard. While a final comprehensive standard should address the accounting for non-life contracts, we believe the existing model for non-life contracts provides users with the relevant and reliable data that allows for decision useful information. In particular, we object to the use of CEV as it relates to non-life for the following reasons:

- The proposed CEV measure is based on a hypothetical transfer of insurance contracts that rarely occurs in reality — insurers do not routinely transfer their insurance businesses, and regulatory and contractual issues make doing so difficult. A measure based on a transfer that seldom takes place cannot be a relevant measure.
- The proposed CEV measurement approach would reduce transparency. It is inconsistent with how management assesses and monitors this business, and inappropriately intertwines market-based assumptions of investment income and underwriting performance. This would reduce the predictive value of the reported results of operations and financial position and would reduce the financial statement user’s ability to gauge the long-term success or failure of an insurance company with respect to non-life contracts.
- Many of the assumptions required to measure CEV are not observable, making the approach impractical. (See "Recommended Improvements to Proposed CEV Model for Life Contracts" below for recommended improvements to the practicability of the approach.)

A model for life insurance contracts

In contrast to the non-life insurance contract model, the accounting for life insurance contracts under US GAAP involves multiple accounting models, and diverges from GAAP in other countries. Therefore, the accounting for life insurance is more likely to be improved by change than the accounting for non-life insurance. The proposed CEV approach described in the DP serves as a good starting point, but needs refinement to ensure its application would be practical and would result in relevant information. Because pricing and underwriting results for life insurance, unlike non-life insurance, incorporate anticipated investment income, incorporating that notion in the measurement of the insurance liability would not affect transparency (in fact, this notion is already included in some forms under existing US GAAP models applicable to life insurance, such as the SFAS 60 long-duration model.)

Recommended Improvements to Proposed CEV Model for Life Contracts

The DP outlines a conceptual model with a building block approach to measuring the CEV that would, in theory, represent what a market participant would pay to assume all of the rights and obligations associated with the insurance contract. These building blocks include:

- Explicit, unbiased, market-consistent, probability-weighted average and current estimates of the contractual cash flows;
- Current market discount rates that adjust the estimated future cash flows for the time value of money; and
• An explicit and unbiased estimate of the margin that market participants require for bearing risks (a risk margin) and for providing other services, if any (a service margin).

We generally believe an entity's own assumptions are more relevant than marketplace assumptions for cash flows, interest rates, and risk and service margins. The CEV model is based on a hypothetical transaction that does not occur with any level of observability in the market. Because the insurance company is more likely not to transfer the insurance contracts (the DP specifically acknowledges, "in most cases, insurers cannot transfer the liabilities to a third party and would not wish to do so" - Paragraph IN22), its own assumptions are more relevant.

That said, we expect an entity's own estimates of contractual cash flows would not vary significantly from another market participant's assumptions. Life insurance contractual cash flows are relatively predictable at the portfolio level.

We expect an entity's own estimate of the applicable discount rate, which broadly would be based on observable markets, would similarly approximate another market participant's assumption. However, we believe it is worth clarifying that the discount rate should be consistent with a rate that would be earned on investments that a market participant would be expected to make to support the life insurance contract liabilities. If "market participant" in this context would be a similarly-rated insurer of similar size and subject to similar regulation, it is likely the market participant's investment portfolio would be managed similarly to the entity's own investment portfolio.

The risk margin should at all times be sufficient to provide for payment of all expected future obligations with adequate provision for risk and uncertainty. This risk margin should be calibrated at inception to the premium / pricing, such that there is no accounting gain recognized at inception. Profits on life insurance contracts should emerge over the life of the insurance contract.

The servicing margin must be based on entity-specific assumptions. The requirement to use market information to estimate the liability for future servicing will result in entities that are less efficient than the market at servicing insurance contracts reporting insurance contract liabilities at an amount lower than their own expected cash flows (deferring losses to a later period), and those that are more efficient than the market reporting insurance liabilities at an amount above their own expected cash flows to service that business. This result is troubling to us, and our view is shared with many other preparers and financial statement users, who fail to see the relevance of measuring a liability based on "market" cash outflows that are never expected to be paid by the insurer. We acknowledge that the current fair value measurement model for servicing rights under SFAS No. 156, Accounting for Servicing of Financial Assets, does require the incorporation of market-based assumptions, regardless of whether the servicer is more or less efficient than the market. However, servicing assets arise, and are separately identified and measured, as a result of observable market securitizations of the underlying financial assets, such as mortgages, credit cards, or auto loans. In contrast, for most insurance contracts, such a securitization market does not exist. Due to this lack of market observability, we believe that the use of such market-based assumptions with respect to the service margin for insurance contract liabilities will not result in reliable and decision useful information, as may be the case for servicing rights.
In addition to improving relevance, use of an entity's own assumptions will be more practical in the preparation of financial statements and more reliable for the users of those statements. There is no observable market data for risk and service margins. A requirement to manufacture them for financial reporting would add undue burden to the already tight closing timetables. However, an entity would know its own current pricing for similar contracts (or its own current assumptions for similar inputs, even if the contracts are less similar), increasing the reliability of the amounts reported in the financial statements. Pointing to "the market" loses some level of reliability and accountability, and there would likely be a wide range of perceptions as to what "the market" means, decreasing the comparability and decision-useful nature of such measurements.

Concluding remarks

AIG appreciates the opportunity to comment on the ITC in the interest of improving the accounting standards applicable to insurance contracts. While we believe the existing model for non-life contracts is not in need of significant improvement, we agree that financial reporting for life insurance contracts can benefit from modification. The proposed CEV approach in the DP provides a baseline framework for life contracts, but must be improved upon to ensure the resulting financial measures are relevant and reliable.

If members of the Board or FASB staff have any questions with regard to this letter, I can be reached at 212-770-6463 to discuss at your convenience.

Very truly yours,

/s/ Mr. Anthony Valoroso
Deputy Comptroller
Director, Accounting Policy

Cc: Steven J. Bensinger, Executive Vice President and Chief Financial Officer
   David Herzog, Senior Vice President and Comptroller
Appendix A – Responses to Questions


Question 1: Is there a need for the FASB to comprehensively address accounting for insurance contracts? Why or why not?

(a.) What aspects of existing U.S. GAAP accounting for insurance contracts could be improved or simplified and how pervasive are these issues?
(b.) How important is the development of a common, high-quality standard used in both the U.S. and IFRS jurisdictions?

We encourage the FASB to add a joint project to its agenda with the IASB on insurance contracts. Due to the large number of fundamental insurance-accounting issues that will interact with existing convergence projects, it is important for the FASB to be fully engaged in the insurance contracts project. FASB’s leadership will help to ensure US constituents are actively engaged in developing this guidance.

US GAAP accounting for insurance contracts is well established but differs significantly between life contracts and non-life contracts, because non-life contracts generally provide specific coverage over a short period of time, while life contracts generally provide insurance coverage over an extended period of time. As a result of inherent differences in the nature of the insured risks, cash flows are generally much more predictable for life contracts than for non-life contracts, especially long-tail casualty products. In general, the accounting for most non-life insurance contracts under US GAAP is not overly complex, is well understood by financial statement users, and is consistently applied across most non-life contracts. In fact, the US GAAP model for non-life contracts is substantially the same as that used in many other countries with established accounting frameworks (e.g., the UK) and in most other countries throughout the world today in the absence of a single comprehensive IASB standard. While a final comprehensive standard should address the accounting for non-life contracts, the existing model for non-life contracts is in little need of modification.

In contrast, the accounting for life contracts under US GAAP involves more than one accounting model and is much more complex than the non-life model. As a result, life insurance accounting under US GAAP may not provide financial reporting measures that are intuitive to financial statement users. We believe the creation of a comprehensive model to simplify and improve the existing accounting framework for life insurance contracts should be the focus of the joint project.
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 US financial reporting for insurance contracts? If not, why not?

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?

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

The DP presents a proposed approach to measuring insurance contract liabilities for financial reporting purposes under which all insurance contract liabilities would be measured at the amount at which all of the rights and obligations under the contract could be transferred to a hypothetical market participant – a model consistent with the IAS model for accounting for financial instruments. Given the lack of an observable market for the transfer of most, if not all, insurance liabilities, this model is largely conceptual, as evidenced by the many theoretical questions the DP asks constituents to consider and the debate in the worldwide insurance community that has ensued over the past couple of years.

The proposed approach also ignores the important fact that insurance contracts (other than those referred to today in US GAAP as investment contracts) are not simply a collection of cash flows. The insurance company’s obligation to stand ready to perform represents a performance obligation which is not typical in most financial instruments and makes the transfer of the contracts difficult. The model for financial instruments is therefore not appropriate for most types of insurance contracts.

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?

AIG does not believe policyholder accounting for insurance contracts should be addressed by the FASB at this time, primarily because insurance costs are generally not significant to the financial statements of policyholders.

Question 4: How would you address the interaction between the accounting for insurance contracts and FASB’s other projects on the conceptual framework, revenue recognition, liabilities and equities, financial instruments and financial statement presentation? Are certain projects precedential?

AIG believes there is a significant overlap between the aforementioned FASB projects (all of them joint projects with the IASB) and a comprehensive joint project on insurance contracts. It is critical that any project on insurance accounting be closely coordinated with these other projects, most importantly revenue recognition and financial statement presentation. With respect to revenue recognition, there is considerable debate about whether it is appropriate to recognize a gain at the inception of an insurance contract, even before services are performed, a phenomenon that is not precluded under the proposed model in the DP. Further, it will be necessary to determine whether, or
under what circumstances, all or some portion of payments received or due from policyholders should be recognized as revenue. This should be addressed early in an insurance contracts project, as it will have a significant impact to the determination of what it is that is being measured.

In addition, we believe a decision with respect to financial statement presentation for insurance contracts can only be made after a careful consideration and analysis of what financial measures drive the financial statement users' analysis of the performance of an insurance enterprise. This determination, in turn, could have an impact on the relevant measurement attribute for insurance contracts, further supporting the need for coordination and simultaneous consideration of these projects.

In our view, only deliberate coordination of an insurance contracts standard with all of the aforementioned existing joint projects will result in the successful development of a common set of high-quality global accounting standards. The FASB should strive to minimize the possibility that preparers, auditors, regulators, and users of insurance company financial statements will experience two or more significant measurement and/or financial reporting changes in a relatively short period of time.
Appendix B – AIG Comment Letter on the IASB DP

[ATTACHED]
November 16, 2007

Mr. Peter Clark  
The International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH

Dear Peter:

American International Group, Inc. (AIG) appreciates the opportunity to comment on the IASB Discussion Paper ('DP') - Preliminary views on Insurance Contracts.

American International Group, Inc., a Delaware corporation, is a holding company which, through its subsidiaries, is engaged in a broad range of insurance and insurance-related activities in the United States and more than 130 countries and jurisdictions. AIG's primary activities include both General Insurance and Life Insurance & Retirement Service operations. Other significant activities include Financial Services and Asset Management. AIG's common stock is listed on the New York Stock Exchange, as well as the stock exchanges in Paris and Tokyo.

AIG is a member of both the Group of North American Insurance Enterprises (GNAIE) and the American Council of Life Insurers (ACLI), and is generally supportive of the positions taken in the GNAIE and ACLI comment letters on the DP.

We support the long-term strategic priority of the FASB and IASB to work towards the convergence of U.S. and International Accounting Standards through the development of a common set of high-quality global standards. Currently, there is diversity in the accounting standards applicable to the accounting for insurance contracts, particularly with respect to life insurance contracts. Accordingly, we believe for life insurance contracts there is room for improvement, as described more fully in this letter. However, we believe that the accounting model for non-life insurance contracts, followed today by most companies around the world, largely based on US or UK GAAP, is well understood by users, is not in need of wholesale changes, and accurately reflects how management views the business. Therefore, as more fully explained in this letter, we do not favor a fundamental change to the recognition, measurement, and financial reporting of non-life insurance contracts. We would, however, support disclosure of additional decision-useful information.
We believe that any proposal for insurance accounting should result in liability measurements that can be consistently and reliably determined and provide predictive value, being representative of the way financial statement users (including management) evaluate and analyze the business. While the DP is a start in addressing this goal, we have significant concerns with many aspects of these proposals. Our key concerns are outlined below.

**Current Exit Value Approach**

At the heart of the DP is a preliminary proposal for the measurement of insurance contract liabilities. The DP describes the proposed measurement approach for insurance contracts as current exit value (‘CEV’), defined as the amount that a market participant would accept to assume all of the rights and obligations associated with an insurance contract at the measurement date. The DP outlines a conceptual model with a building block approach to constructing an amount that would, in theory, represent what a market participant would pay to completely assume all of the rights and obligations associated with the insurance contract. It is important to note that the DP specifically acknowledges, "in most cases, insurers cannot transfer the liabilities to a third party and would not wish to do so." (Paragraph IN22) Because of this fact, an observable market for the transfer of existing insurance contracts does not exist. Due to the absence of an observable market and given the fact that most insurers either cannot transfer, or have no intention of ever transferring, their insurance liabilities to another party, we question the relevance of such a measurement for financial reporting purposes. We believe that a key objective of financial reporting is to provide information that assists users in assessing the actual future cash flows of the entity. In sum, we do not believe the proposed CEV, as defined, will provide decision usefull information that will enable users to make sound economic decisions for the following reasons:

- It is based on a hypothetical transfer value that is not independently verifiable.
- There are no observable markets for the transfer of insurance contracts in their entirety or for the 'lay off' of the significant underlying financial and non-financial risks of an insurance contract.
- Transactions involving the actual transfer of insurance liabilities are a result of specific individual negotiations between two contracting parties after significant due diligence efforts. Details of the significant pricing inputs for these transactions are not readily available to parties other than the contracting parties.
- Transactions involving non-life liabilities that are true legal transfers (where liabilities are extinguished for legal and accounting purposes) are rare and when they do occur they are most often in "run-off" situations that should not be used as a basis for the determination of transfer amounts in a “going concern” scenario.
- The proposed CEV approach can be interpreted to require a compensation or consideration element, and not solely represent the ultimate expected cost required by the hypothetical marketplace participant, as it is reasonable to assume that any third party intending to acquire a group of insurance contracts would almost certainly desire a profit margin above and beyond its expected costs. The difference between the compensation element and the expected or actual cost is likely to be significant and could vary from contract to contract, largely dependent upon the type of insurance liabilities acquired, varying expense structures, individual purchase requirements and other idiosyncratic reasons as to why a particular book of business is being acquired.
• The proposed CEV approach, wherever possible, gives little regard to important entity specific assumptions and inputs, but instead relies heavily on “market inputs” that are largely unobservable, especially for non-life insurance contracts.
• The development of the proposed CEV approach was largely focused on highly predictable insurance/savings products (e.g. equity indexed annuities), but is impractical when applied to other forms of insurance.

We recognize that the IASB’s focus on average market-based data (rather than entity-specific data) is consistent with the proposals that the IASB is developing in other projects, but we do not believe that market data is superior to entity-specific inputs in this case, due the factors cited above. Given that it is the objective of financial reporting to measure the actual performance and financial position of the reporting entity, entity specific assumptions are more relevant when “market inputs” cannot be readily and reliably obtained.

Nature of Insurance Contracts

In many respects, we believe that the CEV approach is being modeled on the accounting for financial instruments, and largely ignores the unique service components of insurance contracts. A fundamental difference is that an insurance contract is inherently viewed by both the insurer and the policyholder as containing a significant service element that is not readily found in most financial instruments – at its heart, an insurance contract includes a service element on the part of the insurance company, and a contingent obligation to make payments if insured events occur. This is similar to the concepts underlying FASB Interpretation No. 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.”

The service element is most prevalent in the claims handling process for non-life contracts. Because each claim is unique, the claim handling process for such contracts varies. Below are the typical steps performed by an insurance company in processing a non-life claim:

• Investigate the facts by interviewing relevant parties
• Determine if coverage applies and the corresponding limits
• Determine who is liable
• Evaluate what is reported
• Investigate and resolve any discrepancies
• Inspect the property and estimate damages
• Identify related injuries
• Prepare an estimate
• Discuss repair options
• Complete the claim process and finalize all necessary paperwork
• Recover the deductible and litigation

The amount of time required to handle each claim varies based on the severity of the damage, the number of parties involved and other factors. Some claims may be simple enough to handle in a single phone call, while others are more complex and require additional research in order to help protect the policyholder. For instance, in a catastrophe, the length of the process depends on a variety of factors including the ability to handle a large volume of claims; there may be hundreds or even thousands of
income, but has not traditionally been considered in “underwriting performance”. In fact, the anticipation of investment income in the pricing of non-life contracts is a philosophy that has historically led to insurer insolvency, because the risks of underwriting often outweigh the potential for investment income. Critical to the evaluation of underwriting performance is liability estimation accuracy. The CEV approach inappropriately intertwines market-based assumptions of investment income and underwriting performance in a manner that reduces the predictive value of the reported results and financial position, thus reducing the financial statement user’s ability to gauge the long-term success or failure of an insurance company with respect to non-life contracts.

In contrast, investment income is a critical element in the pricing and underwriting performance measurement of life insurance contracts, which are generally expected to provide insurance protection for an extended period of time, backed by investments with durations matched to the expected durations of the insurance contracts. Investment performance is not viewed and managed separately in this case, as it is an integral element to the pricing of a life insurance contract.

**Unintended Consequences of the Current Exit Value Approach**

We have significant concerns that the implementation of the CEV approach, as proposed, could result in unintended practical consequences for the insurance industry. The most significant of these are discussed below.

**Profit at Inception**

Most importantly we believe that further investigation and discussion is required regarding the appropriateness of an insurer recognizing any profit upon the issuance of an insurance contract, as permitted under the CEV. Given the lack of observable markets, uncalibrated risk margins and the use of market average inputs could create gains at inception. The IASB has stated that they believe that the possibility of profit on inception is likely to be infrequent and not significant. However, a recent insurance industry presentation in Europe published market-consistent Embedded Value numbers that were calculated in a manner broadly consistent with the DP proposals, that would result in a combined gain at issue of up to $7 billion. Given the diversity of methodologies being proposed, we question whether the most subjective area of the CEV measurement calculation, the explicit risk margin, can be reliably and consistently measured and we are troubled by the potential for earnings management created by such an approach.

**Under or Overstatement of Service Liabilities**

The requirement to use market, as opposed to entity-specific, information to estimate the liability for future servicing will result in entities that are less efficient than the market at servicing insurance contracts reporting insurance contract liabilities at an amount lower than their own expected cash flows (deferring losses to a later period), and those that are more efficient than the market reporting insurance liabilities at an amount above their own expected cash flows to service that business. This counterintuitive result is troubling to us, and our view is shared with many other preparers and financial statement users, who fail to see the relevance of measuring a liability based on cash flows that are never expected to be paid by the insurer. Further, the absence of an observable market for these costs will mean that companies will most likely have a wide range of different perceptions as to what
"the market" means, further decreasing the comparability and decision useful nature of such measurements.

Interaction with Solvency II

There is a need to closely monitor developments in future regulatory reporting i.e. Solvency II. The basic premise and objectives of the proposed Solvency II framework and the DP appear to be so intertwined, in that similar current exit value approaches for the measurement of technical provisions have been developed for both Solvency II and IFRS. The only notable key difference between both is that Solvency II, understandably, does not address accounting issues such as profit recognition. Currently, Solvency II proposals are expected to result in lower technical insurance liabilities than the DP proposals, given that Solvency II is not concerned with accounting issues such as the recognition of profit at inception. Recently this issue has been a matter of much debate. We understand that the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) are concerned by a possible higher level of liabilities for accounting than for solvency. We do not agree that this profit margin should be recognized at inception, either in the income statement or as an adjustment to stockholders' equity.

Furthermore, in the absence of appropriate guidance, we are concerned that Solvency II might become the 'default implementation guidance' for the calculation of the technical provisions. Specifically, Solvency II is proposing an uncalibrated risk margin determined using a 'market consistent' 6% cost of capital rate, which is unrelated to the insurers actual cost of capital rate. This arbitrary 6% rate and the use of market consistent 'volatility factors' are meant to capture the riskiness of insurance liabilities and changes in market cycles, but we believe they fall significantly short of doing so. Arguably, in some instances, depending on where one is in the cycle, the actual cost of capital rate for some long-tail casualty liabilities could be multiples of this 6% rate.

Considering that the CEV approach underpins Solvency II, this could create an unlevel global playing field. CEIOPS is about to undertake a 4th Quantitative Impact Study. These studies are providing much needed field testing to ensure that the proposals are being appropriately calibrated and tested. While we appreciate the desire by some players in the global insurance industry to ensure that Solvency II and a final IFRS are consistent wherever possible, we are concerned in the absence of field testing by the IASB that Solvency II could inappropriately pave the way for the implementation guidance for the IFRS standard. In the US, regulators and investors employ different processes using different methodologies because they have different purposes, and for this reason we believe the differences between the objectives of Solvency II and IFRS should be fully explored and any differences measured appropriately.

This distinction between the role of Solvency and IFRS, which we fully support, is stated in paragraph 4c Chapter I of the DP as follows "In some cases, accounting for insurance contracts has been heavily influenced by supervisory concerns. This has sometimes resulted in methods that do not distinguish clearly between an accounting question (What assets and liabilities does the insurer have?) and a management and supervisory question (What assets should an insurer hold to give sufficient assurance of satisfying its existing obligations?) We agree that the accounting for insurance contracts should not be heavily influenced by supervisory concerns."
Relationship with Other IASB Projects

The IASB, in conjunction with the FASB, currently has a number of key projects under review that directly impact the insurance contracts project, namely the conceptual framework, revenue recognition, performance reporting, financial instruments and equity and liability projects. It has become evident to us during the discussions at the Insurance Working Group meetings, that the concepts in the DP have not been thoroughly considered outside of this project and may be of heightened interest among those outside the insurance industry. These concepts are both untried and untested, and we are concerned that the insurance industry is being used as a testing ground for many of the ideas in these other areas. It is therefore important that the implications of concerns expressed on other IASB projects by other industries are adequately understood and considered as part of the parallel debate on insurance contracts. We believe firmly that the insurance contracts standard should not be finalized until the proposals for these other fundamental areas of accounting are fully debated and any implications on the insurance project fully explored.

Interaction with the FASB and U.S. Users

Consistent with the broader goal of international convergence expressly desired by the IASB and Financial Accounting Standards Board (FASB) in the U.S., we believe it is critical for the IASB to coordinate its efforts going forward with the FASB on this important project. We are concerned that the FASB has not fully joined the process and will need to begin sooner versus later or risk becoming less influential in the outcome of this project. While certain members of the U.S. insurance industry have been keenly focused on this project since it began and continue to be actively involved in the standard setting process, recently, we have noted that others have not been engaged. The user community in the U.S. has more recently become engaged and will provide valuable insight into the usefulness of a worldwide set of accounting standards for insurance contracts, to ensure such guidance results in better understandability and decision useful information for investors and other stakeholders.

Field Testing

We believe that the IASB should consider the use of field testing before a final decision is reached on any new accounting standard for insurance contracts. It is our understanding that many countries throughout the world utilize some form of U.S. or U.K. GAAP to account for insurance contracts, especially non-life contracts, for local financial reporting purposes. Whatever approach the IASB ultimately decides upon will most likely differ, in some respects, from current practice. To this end, we believe it is critical for the proposed model (or models) to be field tested prior to the issuance of a final standard to ensure that such guidance can be (1) practically implemented, (2) consistently applied to a wide range of products across different companies and, most importantly, (3) demonstrated to provide relevant, reliable and decision useful information to financial statement users. We believe that field testing should occur prior to the issuance of an exposure draft to ensure that concerns are raised during the deliberation process, thus avoiding the potential of multiple exposure drafts.

Cost versus Benefit

We believe that the accounting practices put forth in the DP would result in significant cost and effort to implement and maintain. To develop such a model would require an enterprise to consider inputs
that are not readily available for insurance liabilities, thereby causing an enterprise to use significant entity inputs or an entity's own internal estimates and assumptions. The valuations to attain the DP's proposed objective will not be achieved without undue cost and effort for an enterprise that has a large volume of insurance contracts. We question a proposal that would require such a significant cost and, in our view, would result in financial information with less relevance to users.

Disclosure

Reporting accurate and reliable financial reporting should be the objective of any accounting framework. As such, application of an exit value approach can only be suited for disclosure purposes. Disclosure is preferable as it may fulfill the need to communicate information to interested parties allowing those parties to base decisions on fair value estimates if they chose, but in no way should be the principal means of communicating accounting information to readers, especially for non-life insurance.

Responses to the selected questions posed in the DP are included in the attached Appendix. If members of the IASB's staff have any questions with regard to this letter, I can be reached at 212-770-6463 to discuss at your convenience.

Very Truly Yours,

/s/ Mr. Anthony Valoroso
Deputy Comptroller
Director, Accounting Policy

Cc: Steven J. Bensinger, Executive Vice President and Chief Financial Officer

David Herzog, Senior Vice President and Comptroller
Response to questions

Q1: Should the recognition and derecognition requirements for insurance contracts be consistent with those in IAS 39 for financial instruments? Why or why not?

No. We do not believe that the recognition and derecognition requirements for insurance contracts should be consistent with those in IAS 39 for financial instruments because insurance contracts differ from most other financial instruments. In particular, we believe that the recognition requirements for insurance contracts should differ from those for financial instruments for the following reasons:

1. Insurance contracts contain an element of "service" that is not present in most financial instruments accounted for under IAS 39, as the insurance company has a stand-ready obligation to adjust and pay claims (non-life) and manage the investment of premiums to build up policyholder account value (life).

2. In contrast to most financial instruments accounted for under IAS 39, an insurance contract entitles the holder (or designated beneficiary) to be compensated only if the holder dies, is injured, or otherwise suffers a financial loss during the coverage period due to a fortuitous change in their health or an adverse change in the value of a specific asset or liability for which the holder is at risk.

For the above reasons, the liability for an insurance contract should be recognized at the date that coverage is bound (i.e., the effective date of coverage) and the performance of services begins. If any premiums are received in advance of the effective date, such an amount would be best characterized as a deposit liability, until all contingencies are met, which will generally coincide with the effective date of the policy.

Most financial liabilities can be derecognized on the balance sheet in accordance with IAS 39, if all amounts contractually due are paid in full. In contrast, with many insurance contracts, the amount due may be subject to a limit that has not been reached such that the holder must generally sign a legal release to agree to the settlement before a claim liability can be derecognized.

Q2: Should an insurer measure all its insurance liabilities using the following three building blocks:
(a) explicit, unbiased, market-consistent, probability-weighted average 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 unbiased estimate of the margin that market participants require for bearing risks (a risk margin) and for providing other services, if any (a service margin)?
If not, what approach do you propose, and why?

The current exit value approach proposes a single measurement model for both life and non-life insurance contracts, incorporating the three building blocks. We believe that it is appropriate to comment on the application of this model to non-life contracts separately from life contracts, due to the
distinctly different characteristics of these two types of contracts. Summarized below are our comments on the building blocks first for life and then non life contracts.

**Life contracts**

We believe that the three building blocks outlined in the DP are a good start with respect to the development of a relevant measurement attribute for life insurance contract liabilities for the following reasons, when viewed on a portfolio basis:

- Lapse studies and mortality statistics can be used to predict with relative accuracy when, and if, a life claim will ultimately be paid
- When a loss occurs, ultimate claim amounts are generally known (i.e. equal to the face amount of the policy)
- A financing component (i.e. investment income) is inherently considered in the pricing and measurement of performance given the long term nature of the policyholder relationship.

However, we have the following comments with respect to each building block, which we believe would improve the reliability and relevance of the resulting liability measurement.

2 a) **Cash flows**

We agree that estimated cash flows is the first building block to developing a liability estimate for life contracts (including expected renewals). Because we believe that "portfolio-specific" estimated cash flows with respect to mortality and lapse rate assumptions taken from a market participant perspective should be closely aligned to an entity's own estimates of such cash flows in most cases, we believe that entity-specific cash flows will represent a more relevant basis for determining the liability, especially where market-based maintenance and servicing cost assumptions differ significantly from the entity's own cost structure, potentially distorting the actual expected future obligations of the insurance entity.

2 b) **Discount rate**

We believe it is appropriate to discount estimated cash flows for life contracts at a rate that is consistent with a rate that would be earned on investments that a market participant would be expected to make to support those liabilities. This rate would reflect the spread that an insurer would expect to earn from the financial management of the business. We do not believe that the risk free rate is appropriate as a discount rate, because it is not realistic to believe that a market participant would back insurance liabilities solely with risk free investments.

2 c) **Risk Margin**

For life contracts, the risk margin should at all times be sufficient to provide for payment of all expected future obligations with adequate provision for risk and uncertainty. Consistent with the view of at least six Board members, we believe that the risk margin should be calibrated at inception such that there is no accounting gain recognized. We believe that any profit margin should emerge through the duration of the insurance contract as services are performed with the passage of time. Applying risk margins without initial calibration, we believe, will result inevitably, in a lack of consistency among insurance companies.
Non-life contracts

2 a) Cash Flows

We agree that estimated cash flows is the first building block to developing a liability estimate for non-life contracts. However, given the lack of market observable information with respect to expected cash flows on non-life insurance contracts, (especially for longer-tail lines of business), we believe that entity-specific cash flows represent a more relevant basis for determining the liability. The few observable transactions often include value of agency, brand, and home office as well as synergies, and thus they are not representative of an observable transfer value for just the insurance contract. We maintain that "market-based" servicing, settlement and other cost assumptions may differ significantly from the entity's own expected cost structure, distorting the actual expected future obligations of the insurance entity.

2 b) and c) Discounting and Risk Margins

We believe that for non-life contracts the liability should be measured consistent with the short-duration model under SFAS 60, which is similar to the current methodology employed by most companies worldwide that follow US or UK GAAP.

Although conceptually possible, we do not believe that discounting and risk margins will improve the decision usefulness of the nominal estimates provided today to financial statement users because of the additional uncertainty that will be added to a measurement that is already highly judgmental and subject to significant measurement uncertainty.

We are generally opposed to discounting non-life claim reserves except when there are fixed and reliably determinable cash flows to discount. We believe that discounting uncertain cash flows only increases the subjective nature of these estimates, and would make these estimates less meaningful for investors. This is particularly the case for long tail non-life liabilities that do not have a reliable and predictable historical claims payment pattern and are subject to an ever changing legal, social and scientific environment. Evidence of this is the fact that, as recent history has shown, even well managed insurers have to strengthen loss reserves from time to time, often for amounts that are significantly different in timing and amount from original estimates. The use of risk margins in the measure of CEV is not consistent with what we view to be the objective of financial reporting, which is to provide readers with decision-useful information about the financial position, results of operations and cash flows of the reporting entity. Incorporating risk margins into the measure of a liability, based upon a hypothetical market participant, reduces the predictive value of the financial information provided, because the transfer in question typically does not occur (and in many cases, cannot occur for legal or regulatory reasons) and cannot be quantified reliably.

For non-life business, we are generally opposed to discounting and risk margins for the following reasons:

- While the timing and amount of future cash flows for a portfolio of life insurance contracts can be predicted with a relatively high degree of accuracy, due to the existence of reliable and consistent historical mortality and lapse experience, for many long-tail non-life lines of
business, in contrast, the amount and timing of expected loss and loss expense payments can vary significantly due to numerous factors for which historical results cannot be used as an accurate predictor of future experience. Discounting highly uncertain cash flows and adding risk margins that can vary significantly due to the lack of market observable market information will only increase the subjective nature of the cash flow estimates reducing the relevance to investors and other financial statement users.

- Underwriting performance based on nominal measures of premiums, losses and expenses, is a key and well-understood success factor for non-life insurers today, as viewed by both management and financial statement users. Discounting with risk margins intertwines investment income and underwriting performance as traditionally measured and uses market-based assumptions that, we believe, will reduce the relevance of the resulting value, that may mask the true success or failure of the insurance company with respect to these types of contracts.

Q3: 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?

We believe the guidance on cash flows is at the appropriate level of detail.

We recognize that given the diversity of methodologies being proposed for risk margins, the most subjective area of the CEV measurement calculation, cannot be reliably measured with consistency and comparability across various products and between companies without additional guidance. Any additional guidance that could be provided for risk margins, on the other hand, would undoubtedly result in a prescriptive approach that would deviate from the CEV principle the Board is attempting to establish and would undermine the notion of an exit value approach.
Q4: 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 this 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).

We support option (a) for both life and non-life insurance contracts.

Q5: This 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. This 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 favor and why?
(b) Is 'current exit value' the best label for that measurement attribute? Why or why not?

We do not believe the proposed CEV approach, as defined in the DP, will provide decision useful information that will enable users to make sound economic decisions for the following reasons:

- There are no observable markets for the transfer of insurance contracts in their entirety or for the "lay off" of the significant underlying risks of an insurance contract.
- In practice, most transactions involving the actual transfer of insurance liabilities occur in an imperfect market and are a result of specific individual negotiations between two contracting parties.
- Most of the transactions involving non-life liabilities that are true legal transfers (where liabilities are extinguished for legal and accounting purposes) are rare and when they do occur they are in "run-off" situations that should not be used as a basis for the determination of transfer amounts in a "going concern" scenario.
- We believe that the proposed CEV approach can be interpreted to require a compensation or consideration element, and not solely represent the ultimate expected cost required by the hypothetical marketplace participant, as it is reasonable to assume that any third party intending to acquire a group of insurance contracts would almost certainly desire a profit margin above and beyond its expected costs. The difference between the compensation element and the expected or actual cost is likely to be significant and could vary from contract to contract, largely dependent
upon the type of insurance liabilities acquired, varying expense structures, individual purchase requirements and other idiosyncratic reasons as to why a particular book of business is being acquired.

- The proposed CEV approach, wherever possible gives little regard to important entity specific assumptions and inputs, but instead relies heavily on market inputs that are largely unobservable.

We believe that a key objective of financial reporting is to provide information that assists users in assessing the actual future cash flows of the entity. Due to the absence of an observable market and given the fact that most insurers either cannot transfer, or have no intention of ever transferring, their insurance liabilities to another party, we do not believe that CEV is a relevant measure for financial reporting purposes.

Q6: In this paper, beneficial policyholder behavior 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 behavior, 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?

Notwithstanding our concerns with the proposed CEV approach, we are supportive of incorporating all policyholder behavior, including beneficial policyholder behavior, and therefore we support either option (a) or (b), with a preference for (a). Whether the customer relationship is recognized as an asset or netted as a component of the liability is a matter of presentation as opposed to measurement, and should be considered in the overall discussion of financial statement presentation for insurance contracts. Our preference would be to reflect such an amount as an asset, in order to provide financial statement users with more relevant information with respect to the components of the overall net liability measurement. This presentation will also avoid the potential presentation of negative liabilities for less mature lines of business.

Q7: A list follows of possible criteria to determine which cash flows an insurer should recognize relating to beneficial policyholder behavior. 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 favors 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 favor 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 or 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 behavior

(f) Other (please specify).

Notwithstanding our concerns with the proposed CEV approach, we support option (b), because a market participant would incorporate all cash flows arising from existing contracts, regardless of enforceability or whether such cash flows result in a benefit to the insurer or the policyholder. Cash flows in a liability measurement attempting to measure an amount at which all rights and obligations would be "transferred" to a market participant can only be relevant and reliable if based on amounts expected to be paid and received under all possible scenarios.
Q8: Should an insurer recognise acquisition costs as an expense when incurred? Why or why not?

Under the proposed CEV approach, acquisition costs are expensed when incurred. However, the proposed CEV approach does not preclude the recognition of a customer relationship intangible (whether recorded as an asset or netted in the liability calculation) which reflects offsetting compensation to the insurer for incurring those costs upfront, in the form of a "lower" estimated cost to transfer the remaining rights and obligations under the contract to a third party. We are in favor of an approach that would recognize that the cost of acquiring a customer relationship is one that needs to be considered as either a separate asset or as a component of the liability.

Q9: Do you have any comments on the treatment of insurance contracts acquired in a business combination or portfolio transfer?

We believe that, as currently defined in the DP, CEV is not the equivalent of "fair value" as currently defined in US GAAP as the relevant measurement attribute for all assets and liabilities acquired in a business combination.

As mentioned in our cover letter, we believe that CEV is not a relevant measure given that it has attributes that are at odds with what real market participants would consider in a business combination, such as policyholder behavior, diversification benefits, etc.

Prior to the issuance of an exposure draft, we encourage the Board to clarify and describe the differences between CEV and fair value, including the rationale for such differences.

Q10: Do you have any comments on the measurement of assets held to back insurance liabilities?

We do not believe that establishing the same measurement attribute for insurance contract liabilities and for assets held to back those insurance liabilities should be a goal of the insurance contracts project. In particular for non-life contracts, the mixed attribute model does not provide much difficulty for financial statement users to understand. As previously discussed, measuring the underwriting results by comparing nominal losses and expenses incurred to earned premiums is well understood by the marketplace and by management, and does not need to be improved.

Q11: 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?
With respect to (a), we believe that measurements of insurance contracts should be based on a portfolio of exposures. A portfolio is a group of contracts that are managed together when assessing risk. A portfolio may include one or more contracts but typically will comprise many contracts reflecting the pooling of risks inherent in the insurance business model. The law of large numbers is critical to the economics of insurance. Actuarial methodologies only apply when the law of large numbers can be invoked, and any exit transaction by an insurer would almost certainly involve a portfolio and not an individual contract. Accordingly, measuring liabilities at the individual contract level is not appropriate unless the contract itself is a portfolio of different exposures.

Not withstanding our concerns with the proposed CEV approach, with respect to (b), additionally we believe that risk margins should reflect the benefits of diversification and negative correlations among portfolios as well, as it can be reasonably expected that a market participant would also take this into consideration. Insurers' portfolios, as representative of the market, are often well diversified and there are negative correlations between the portfolios that reduce the overall risk margin/uncertainty in the timing and amount of the cash flows. Diversification benefits are consistent with the law of large numbers as an operating principle of insurance. As risks are spread over a larger population of policyholders and incorporate a wider variety of risks, the impact of increasing risk exposures impacts premium charged as well as the average fixed costs of the insurer.

Q12: (a) Should a cedant measure reinsurance assets at current exit value? Why or why not?  
(b) Do you agree that 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.  
(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.  

The measurement-basis for ceded reinsurance assets should be consistent with the corresponding insurance claim liabilities. Consistent with our previous comments, that basis should not be CEV.

With respect to (b), and notwithstanding concerns with the proposed CEV approach, we agree with (i), (ii) and (iii).

Q13: If an insurance contract contains deposit or service components, should an insurer unbundle them? Why or why not?

We would not be in support of an unbundling approach for insurance contracts because we believe, in most cases, bifurcation (a) would not provide more understandable or decision-useful information for financial statement users, (b) would be impractical for most, if not all, companies to implement and (c) would likely result in decreased consistency and comparability in financial reporting. In addition, we believe that the initial and ongoing costs associated with a bifurcation approach, both from a preparer standpoint in collecting and processing the necessary information and from a user standpoint in meaningfully analyzing and interpreting that information, far outweigh the benefits that could ever be derived. We believe that it is more appropriate to evaluate an insurance contract in its entirety, because the various components (financing, insurance risk, and servicing) are most often interrelated and would typically not be found as standalone transactions in the marketplace. Policyholders are willing to pay for protection against unanticipated cash outflows including uncertainty regarding both timing and amount. Coverage for timing risk is intrinsic in the construction of every insurance policy thereby making identification and bifurcation of the portion of premiums relating to timing risk (that is, the financing component) impracticable or arbitrary at best. The same would also apply to the service element.

Q14: (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?

Because of our concerns expressed with respect to the CEV approach in general, as expressed in this comment letter, we do not believe that the credit characteristics are relevant in valuing an insurance liability at inception or on ongoing basis. Due to the lack of an observable market for the transfer of insurance contracts, it is difficult to imagine circumstances under which the insurer could realize a benefit or a detriment for small changes in its creditworthiness while it's a going concern. Only in a situation close to liquidation would a potential reduction in liabilities due to an entity's own credit deterioration ever potentially be realized, at which point a solvency, rather than a financial statement, liability measurement would be more relevant to users anyway.

Q15: 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?

We believe that there are unique differences between insurance contracts and financial instruments that should be fully explored and considered, as described in our response to Q1. We would strongly encourage the Board to discuss this as an agenda item at the next Insurance Working Group, or preferably create a sub-group to fully consider this question.

Q18: Should an insurer present premiums as revenue or as deposits? Why?

Please refer to our response to Q19.
Q19: Which items of income and expense should an insurer present separately on the face of its income statement? Why?

Notwithstanding our concerns with the proposed CEV approach, we believe that a decision with respect to financial statement presentation can only be made after a careful consideration and analysis of the following questions:

- What financial measures drive financial statement users' analysis of the performance of an insurance enterprise, perhaps differentiated for life and non-life contracts?
- Do financial statement users, including management, see a need to change these performance measurement metrics?
- What information will provide financial statement users with the necessary understanding of the uncertainties associated with expected future cash inflows and outflows of the entity in order to make meaningful decisions?

Taking a broader view, we believe that the determination, or at least consideration, of any changes to current performance measures (e.g. premiums earned, losses incurred, etc.), especially for non-life insurance contracts, should have been an integral consideration in the development of a proposed conceptual framework for the liability measurement itself. In this regard, we believe that the proposed CEV approach be reconsidered for non-life contracts, taking into consideration the questions above, the answer to which must be obtained directly from financial statement users.

Q20: Should the income statement include all income and expense arising from changes in insurance liabilities? Why or why not?

Please refer to our response to Q19.