October 17, 2013

Technical Director
Financial Accounting Standards Board
401 Merritt 7
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By E-Mail: director@fasb.org


Dear Members of the Financial Accounting Standards Board:

The National Association of Mutual Insurance Companies (NAMIC) appreciates the opportunity to comment on FASB’s Proposed Accounting Standards Update—Insurance Contracts-Topic 834 ("Insurance Contracts ED" or "ED") issued June 27, 2013.

NAMIC is the largest and most diverse property/casualty trade association in the country, with over 1,300 regional and local insurance member companies serving more than 135 million auto, home, and business policyholders and writing in excess of $195 billion in annual premiums that account for 50 percent of the automobile/homeowners market and at least 30 percent of the business insurance market. Our membership is predominantly mutual, but does include stock companies. We represent the very smallest insurance companies in the industry as well as the very largest. Our members are domiciled in nearly every state in the nation, and a large percentage of our members are small mutual insurers.

While many of our mutual members are not required to complete GAAP financial statements, NAMIC still has a significant interest and concern related to the content of the FASB ED. Mutual insurers, like all insurance entities in the U.S., are required to complete National Association of Insurance Commissioners (NAIC) Statutory Accounting annual reporting to state insurance regulators. U.S. GAAP is the primary authority underlying NAIC Statutory Accounting.

The NAIC Statutory Accounting Practices Working Group (SAPWG) develops most of the standards and provides oversight for the NAIC Accounting Practices and Procedures Manual that governs statutory accounting requirements. In this role, SAPWG considers all relevant GAAP ASUs and adopts many of the GAAP standards as part of the statutory accounting manual. That review of FASB pronouncements by NAIC committees results in decisions to follow, modify, or dismiss such FASB pronouncements for inclusion in statutory guidance. It is important to regulators and companies that U.S. GAAP and statutory accounting remain closely aligned. Statutory accounting
generally utilizes the GAAP framework applicable to insurance accounting, so widespread changes in that framework would change the methodology used by all insurers. Consequently, if the FASB adopts the proposed changes to U.S. GAAP, they would likely change the reporting requirements, reserving methodology, operational expense and potentially impact the solvency of NAMIC members.

Further, some of our members are stock companies, have stock affiliates or are otherwise required to complete GAAP financial statements. For all of these reasons, and because of the highly significant changes proposed to insurance contracts accounting, NAMIC determined that it was critical to offer comments on the proposed Insurance Contracts ED.

Complexity of Property/Casualty Insurance

NAMIC members are primarily engaged in short-duration, property/casualty contracts, but this is a complex and diverse business. The premium received from these policies (cash inflow) is predictable and is usually paid within the contract term. Alternatively, the claims incurred and loss adjustment expenses (cash outflows) are often varied in the contract. For example, claims may be paid in different contract terms. They are paid to reimburse for losses related to many different perils. They may be paid to the policyholder, a claimant, a service provider or other party. In addition, depending on the company involved and the claim filed, there may be different conditions required for payment. To further complicate the business:

- At the macro level, there are over 30 lines of personal and commercial insurance business -- some property-only, some casualty only, some package policies including both property and casualty.
- There are significant differences between the management of property and casualty as well as differences between personal lines purchased by individuals and commercial lines purchased by business interests.
- At the micro level, even within a particular policy there is exposure to loss arising out of numerous perils and activities that do not share the same “release from risk” pattern.
- In every state NAMIC members write policies that are subject to different rate plans, as well as different statutes, regulations and case law governing the payment of claims, the definition of when a claim is incurred and the interpretation of when a claim is made.
- Between companies there is often diversity in the benefits and services offered under property/casualty insurance policies as well as the timing of those benefits.
- Overlying all of these differences with reinsurance ceded and assumed by these property/casualty insurers further adds to the complexity.

With all of this complexity and diversity, for decades a U.S. GAAP accounting reporting system has been in place that FASB, auditors, investors, lenders, companies, and regulators alike have found

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decision-useful, consistently evolving, and comparable between entities. FASB has done an excellent job of producing and maintaining the current U.S. GAAP system for insurance entities that is the model for GAAP reporting around the world. The proposed changes to the current U.S. GAAP system for insurance will create unnecessary challenges, significant costs and drastic loss of historical data, while yielding minimal benefit for the users of property/casualty financial statements.

General Concerns and Recommendations

According to the FASB Conceptual Framework for Financial Reporting, the basic goal of revisions to GAAP accounting standards is to improve the decision-useful information available to the users of U.S. GAAP financial statements. The Framework identifies the fundamental qualitative characteristics of useful financial information as relevance, materiality, and faithful representation. The enhancing qualitative characteristics include comparability, verifiability, timeliness, and understandability. Unlike the current U.S. GAAP, the Insurance Contracts ED is inconsistent with these characteristics in numerous respects. NAMIC asserts that the current U.S. GAAP system is far preferable for property/casualty insurers, and that the ED does not represent an improvement of decision-useful information for users of U.S. GAAP financial statements for these insurers.

Specific concerns with the approach of the ED will be provided in responses to the questions posed by the Board but some general concerns follow:

- The current U.S. GAAP for insurance entities provides rich historical data illustrating trends and details that have facilitated insurance industry development over decades. The replacement of the current system will result in the loss of this data for trend and comparative purposes. It will take decades to replace this wealth of information, and the industry, statement users and ultimately consumers will suffer as a result. If the changes to the standards resulted in improvements, they would be weighed against this cost, but there are few identified benefits gained from the proposed ED.

- The ED proposes a completely new construct for insurance contract segmentation, measurement, and reporting (e.g., portfolios of contracts, premium allocation approach) that does not utilize insurance concepts from the current standard. These changes add significant complexity. If adopted in this form, there will be serious “understandability” issues for preparers, auditors, and users, which will challenge “faithful representation” of the information and will affect “timeliness” of reporting.

- The ED contains significant new concepts that are unclear and used inconsistently in different sections of the ED. The lack of clarity can result in varied interpretations and practice diversity that will not support “comparability,” “faithful representation” or “timeliness.”

- Even if FASB addresses the understandability and clarity issues in a redrafted ED, the relevance/benefits of the changes for property/casualty insurers issuing short-duration contracts are highly questionable.

- When questionable relevance/benefits are compared to the costs of lost historical data, changing reserving practices, replacing IT systems, retraining employees, and the potential
loss of valid information for solvency assessments, it is clear that the costs outweigh the benefits.

- The direct result of these imbalanced costs and benefits will be felt by companies attempting to attract capital. Less capital and higher costs will impact the cost of insurance. Ultimately insurance consumers will bear the costs in higher premiums.

- A critical concern is the regulatory precedent. The ED would impose on property/casualty insurance preparers new methodologies to assess and value reserves. The ED goes well beyond improved reporting of decision-useful information for users. In its revisions of the current standards FASB actually replaces the judgment of property/casualty insurance experts — including regulators, actuaries and risk management experts — by requiring a life insurance-based actuarial approach for evaluating and measuring property/casualty reserves.

Resolving these property/casualty insurer concerns is critical to the success of these changes in insurance accounting standards. After decades of application to property/casualty insurers and substantial global convergence, the interpretations of the current standard have been clarified and the standard strengthened. While the Insurance Contracts ED may offer an approach that is consistent with the Life insurance business model, it is not consistent with the property/casualty business model. The proposed changes in the standards raise numerous questions, create significant uncertainty and may well have many unintended consequences. For this reason, our recommendations to FASB are as follows:

- Conduct comprehensive field testing of the ED with property/casualty insurers — mutual and stock; personal lines and commercial; large and small — to resolve all concerns.

- Until field testing resolves all of the concerns, maintain the current U.S. GAAP standards for property/casualty insurers to avoid disruption of the business and the excessive costs of compliance with minimal benefits.

- If issues remain after field testing retain the current U.S. GAAP standards for short duration property/casualty contracts with only targeted improvements to current U.S. GAAP.

- Throughout the process, partner with the primary insurance regulators through the NAIC SAPWG to assure alignment with statutory accounting and consistency with other changes in U.S. and global insurance regulation.

- If revised standards are adopted provide companies with a much longer transition period prior to full implementation of six to eight years.

Specific Concerns

NAMIC strongly recommends that FASB replace the Insurance Contracts ED—as it applies to property/casualty insurance contracts—with targeted improvements to current U.S. GAAP. The superior existing GAAP standards applicable to insurance should be retained unless and until all issues set forth below can be addressed satisfactorily. NAMIC has numerous concerns about the ED including issues of clarity, consistency between entities writing insurance contracts, the unique
impact on the insurance industry, and, critically, the cost/benefit analysis. NAMIC raises many issues in the responses to questions (Attachment), but key areas of concern are as follows.

1. Clarity

Significant issues of clarity exist that drive all of the details of this ED. They need to be resolved if we are to have a full understanding of the proposed insurance contracts accounting standards. A couple of the key issues include the criteria for companies subject to the premium allocation approach and the definition of a portfolio.

   a. Premium Allocation Approach Criteria

The ED is comprised of two measurement models. The building block approach ("BBA"), is the model applicable to most life, annuity, and long-term health contracts. The premium allocation approach ("PAA") is mandatory for contracts with a coverage period of one year or less, or an estimated value of net fulfillment cash flows unlikely to change significantly before a claim is incurred. Short-term contracts would include most property/casualty contracts and annual health contracts. Our concern is with the clarity of the second criteria for contracts with a coverage period in excess of a year. In the Basis for Conclusions, FASB implies that the intent of the criterion was to limit the use of the PAA model short duration contracts under existing U.S. GAAP and contracts over a year with similar characteristics; however, in discussion with industry peers, we have encountered widely differing interpretations of how this criterion would be applied. This language could be read to include all property/casualty contracts under the PAA or to include none of them. Some illustrations of this potential confusion are as follows:

- Property/casualty insurers arguably have very predictable cash flows before a claim is incurred. They receive premiums, they underwrite and issue policies and they pay commissions to agents. Only when a claim is incurred are there variable contractual outflows. Using this analysis all property/casualty contracts would qualify for the PAA.
- On the other hand, property/casualty insurers often learn about storm fronts, wildfires or weather patterns that could increase the “expected” value of net cash flows. If the “period before a claim is incurred” is defined to include even very short periods of time – days or hours – there is often information available that would result in significant variability in expected cash flows the hours before they occur. However, the accuracy of such predictions is questionable, and the potential loss is quickly replaced by real damage information. Disqualifying all property/casualty contracts for terms longer than one year under this scenario would not make much sense, as this characteristic would apply to contracts for terms less than a year as well.
- Finally, if there is information that is available to a property/casualty insurer that increases the potential risk of the policyholder or of the property insured, there are underwriting and loss control actions that insurers take to address that risk. This PAA factor does not seem to consider action that would address such risks.
b. Portfolio of Contracts Definition

The FASB definition of a "portfolio of contracts" is very confusing. The criteria include groups of contracts that (i) have similar risks and that are priced similarly, and (ii) have similar duration and similar expected patterns of release from risk. The configuration of portfolios could vary by company under these criteria, and since this definition drives all other measurements in the ED it is very important that is clearly and consistently applied. Some examples of the potential implementation of the definition follow:

- Under the definition in the ED, some insurers could apply a very granular approach to developing portfolios:
  - A portfolio for each rating territory in each state – not priced similarly;
  - Portfolios separating property from casualty risk – they have different periods of releases from risk;
  - Portfolios separating personal lines from commercial lines contracts – managed separately;
  - A combination of any or all of the above.
- Other insurers may prefer to keep all property/casualty contracts in a single large portfolio.

These differences in applying "portfolio of contracts" leads to diversity in practice and incomparability.

In addition to these issues of inconsistent interpretation of the definition, the term, "portfolio of contracts," is also inconsistently applied throughout the ED. For example, while "portfolio of contracts" is applied to measure revenues in the cash-flow equation, there are problems with similarly measuring liabilities. Currently, claims and reserves are aggregated on an accident-year basis, not a contract year. In fact the ED references a "portfolio of claims" in sections describing the measurement of liabilities, without defining this alternative portfolio. At the same time the ED requires the use of discount rates relating back to the year of inception of the contract. The incongruity in the application of a key component of the ED has created significant concern among NAMIC members.

While the International Accounting Standards Board (IASB) definition of the term, "portfolio of contracts," suffers from many of the same weaknesses, at least it allows insurers to segment contracts to reflect their management of the contracts. This is a preferred approach for NAMIC members.

2. Consistency

One of the primary objectives of financial reporting is to achieve consistency in reporting among entities to enhance comparability. The whole point of the convergence effort is to achieve consistency in reporting among companies around the world. However, lack of consistency resulting in non-comparability between entities is one of the most concerning features of the ED.
There are many issues that will create these inconsistencies including:

- the varying interpretations of definition of portfolio already noted;
- the different methodologies for and uncertainty about determining the appropriate discount rate;
- the application of the PAA to some but not all property/casualty contracts that have similar characteristics with the exception of the coverage period; and
- the potential differences in application of the claims reserving practical expedient.

We propose that the attempts to satisfy the varying and complex differences within insurance entities that arise out of completely different business models are wasted efforts. Life insurance and property/casualty insurance have very different business models. Simply put, life insurance is based on a future benefit model with risks measured by mortality tables and profitability driven by asset investment. This business aligns well with an expected loss reporting system. Property/casualty insurance is an historical, experience-based model, with risks measured on past experience, and profitability based predominantly on appropriate contract pricing. This business aligns well with an incurred premium-loss reporting system.

The best approach would be to keep the current U.S. GAAP standards for the property/casualty industry and work with the life, annuity and long-term disability insurance industries to refine the BBA to address their business model. This solution provides two models — one for property/casualty and one for long-duration life, annuity and long-term disability contracts -- without the creation of comparability problems within industries and without the drastic revision of accounting standards for the entire insurance industry.

3. Unique Impacts on the Insurance Industry

In other international convergence projects FASB has attempted to develop standards that address financial instruments, leases, revenue etc. in the same manner across industries. Despite theoretical attempts to apply the Insurance Contracts ED across all industries to contracts that act like insurance, the reality of the ED includes several exclusions. Insurance is a regulated industry with specific definitions of "insurance" and requires licensing for entities issuing insurance policies. Consequently, the ED has far-reaching effects on those regulated insurance entities and minimal impact outside of the industry.

a. Consolidation of Insurance Industry

The consequences of such an overhaul of the insurance accounting standards could be extreme on this industry. Smaller companies with a single accounting person charged with completing reports may not remain in existence. Even medium-sized and large companies will struggle with the costs of these new requirements. This will drive consolidation in the industry that will not serve the people
who buy insurance. Smaller insurance companies serve some unique markets including, people living in rural areas, businessmen and women in specialized businesses (e.g. florists, jewelers), and farmers to name a few key groups. In many cases these customers have minimal options to meet their insurance needs. Losing a local insurance company to a merger or to dissolution can create insurance availability problems. Financial reporting standards should not be the cause of such a significant reconfiguration and displacement of an industry.


The proposed standards have gone beyond the refinement and improvement of consistent financial reporting and have moved into the realm of changing industry actuarial practice. Some experts indicate that FASB did not intend to change actuarial practices, but that is the effect of the proposed standard. If insurance regulators determined that advancements in actuarial practices around property/casualty reserving were necessary, they would propose changes and the industry would have a debate at NAIC to address the possible revisions. If companies felt that they would gain a competitive edge by updating and changing their actuarial practices around reserving, they also would take this step, working with their actuaries and regulators to accomplish the change. Then the market would determine if other companies would follow suit. But it is outside the discipline of financial reporting to require changes in the specific actuarial methodology for calculating loss reserves.

c. Investment in the Industry

The changes in standards will result in a loss of decades of GAAP reporting data that has proven valuable for users, regulators, and preparers. Losing this historical data and ability to compare company trends, will make future investments in insurance entities more challenging for users – including those considering debt or equity investing. Current analysts and other users of the financial statements have indicated that the ED will create a method of reporting that is not easily understood or deemed useful. This will necessitate significant efforts to teach this new method, explain financial results, derive financials that approximate the pervasive communication of non-GAAP metrics, and most likely increase the cost of capital/debt for insurers ultimately impacting the pricing insurers can provide their customers. Some investors have gone as far as commenting that the insurance sector could become uninvestable.

4. Cost – Benefit Concerns

NAMIC members see little to no benefit in the revised standards. We have also been engaged in conversations with numerous investors, regulators and other users of insurance financial statements and have not heard any evidence that these new standards would produce a benefit for users. We understand the desire to have a consistent international standard that would provide all users with decision-useful information, but even full adoption of the proposed standards would not accomplish convergence. Instead the ED simply creates new reasons for non-comparability, uncertainty and
costs. International convergence, or at least global acceptance, would be far more likely if the current U.S. GAAP standards for insurance were adopted for property/casualty contracts. These GAAP standards are used by property/casualty insurers in nearly all global jurisdictions.

The benefits, if any, of the new standards have not been clearly articulated, but the costs associated with these changes are very evident. It is not difficult to conclude that the costs outweigh the benefits. A few of the key costs are highlighted below, but it is critical to note that the price we will pay goes beyond dollars and cents. The cost will be suffered in the loss of the rich body of historical data. It will be felt by small companies and their customers. It will be in the uncertainty created by the changes. It is not often that an accounting standard can have such an impact, but the changes are so significant that they have risen to that level. Below is a discussion of the key implementation costs and expansion on a few of the unintended consequences.

a. Cost of Converting to Unbiased Probability-Weighted Cash Flow Reserving

For issuers of short-duration contracts, the requirement to move to unbiased probability-weighted cash flow reserving is the item that will increase cost the most and provide the least benefit. For implementation companies will have to hire more actuaries, accountants and systems experts or engage more consultants because the reserving process itself will require a complete overhaul for most property/casualty insurers. Currently, reserving processes focus on determining the ultimate nominal loss and, from that, the appropriate loss reserve to book. In other words, the focus is on the ultimate loss and not the timing or amounts of incremental losses. Property-casualty actuaries will need to develop, test and validate new methodologies to address these reserving estimation requirements. More accounting experts will be required to track the many new variables introduced and explain the complex drivers of financial results to users. Companies will need to change IT systems and processes to shift to a cash flow approach. Many new information technology systems, software and employees will be required to set up and monitor the new processes and track the new variables required by the ED.

Even after implementation, companies will continue to incur added costs to properly apply the proposed guidance and reestablish the significance of the data reflected by the new information produced. Companies will need to engage additional investment professionals to explain to users the drivers of financial results obscured by the complex accounting procedures. Independent auditors will be far more costly as they will need to audit not only the financial reporting but also the actuarial processes implemented. The need for talent to address the reserving changes will be not only a transitional, but an ongoing and expensive cost consideration. The exact costs are very difficult to determine with accuracy, but it will likely be much greater than anyone is currently anticipating. The costs will be very, very significant, indeed.

Another significant, but less measureable, cost related to the revised reserving methodology is the loss of the connection between GAAP and statutory accounting. Statutory accounting explicitly mandates conservatism in reserve estimation so it is unlikely that insurance regulators and the NAIC
SAPWG will adopt the revisions set forth in the ED. The loss of the similarities between the two systems could result in entities carrying differing nominal statutory and GAAP reserves. To maintain both reserve methodologies will cost time, money and resources as well.

b. Cost to Determine Appropriate Discount Rates

NAMIC stresses that the details of the requirement to discount short-duration contracts will also significantly affect cost. The current business model for short-duration property/casualty insurers is inconsistent with a discounting requirement. Issuers of short-duration contracts have neither the expertise to determine appropriate yield curves for the various portfolios, nor the systems in place to maintain discount rates at inception. Overall, application of discounting on the scale required by the proposed guidance is fraught with uncertainties, assumptions and formidable challenges.

Companies discounting reserves will be challenged to establish appropriate rates and develop systems to track those rates, but a significant part of the problem is the price the industry will pay from a solvency perspective. Property/casualty insurers and regulators have always managed claim reserves on a nominal, undiscounted basis. Reserves are an important feature that protect the policyholders and assure that the money needed to pay claims is available. Insurers holding inadequate reserves often struggle to meet their claim obligations when they are due. A.M. Best reports that inadequate reserving is the number one reason for insurer insolvencies.2

NAMIC members care about this issue because insurance insolvencies are not just an issue for troubled companies. All insurers doing business in a state are required to participate in guaranty funds that pay the claims of insolvent insurance companies, so insolvencies affect all insurers whether they report on a GAAP basis or not. Trends toward a present value measurement will not produce more adequate reserves. Instead these trends may lead to less reserve discipline. Appropriate discount rate setting is not a precise science and minor errors in determining the appropriate rate can have disastrous results in this industry.

c. Lost Value of Decision-Useful Historical Accounting Data

One of the most critical costs of changing the current GAAP standards for insurance financial reporting will be the loss of the alignment between U.S. GAAP, Insurance Statutory, and Tax reporting that currently provides very granular, rich information that users and preparers can access to assess performance or the quality of investments. The objective of preparers is to meet the informational needs of users so that they can best assess their risk and reward from transactions with the preparing entity. The ED restrains property/casualty insurers’ ability to communicate with users for the following reasons:

2 AM Best, “Best’s Insolvency Study - Property Casualty U.S. Insurers 1969-2002” (2004). This study points to deficient loss reserves as the primary cause of 562 P&C insurer insolvencies during the study period.
The ED is inconsistent with the business model employed by property/casualty insurers;  
The ED would abolish valuation metrics that investors and other users have come to rely on by eliminating decades of company and industry data.  
Under the ED the adequacy of reserves and reserve development information is overly complex and is presented on a different measurement basis than current claims and claims reserving practices.  
The interaction of discounting with an uncertain payout pattern will distort the true liability of the entity, rendering comparisons to other entities less meaningful than the current standard.  
The aggregation by "portfolio" reduces information concerning company operations as many entities manage business and measure profitability on a different basis (account basis, profit center, etc.).

d. Cost to Small Insurers and Competition within the Insurance Industry

Many small companies have a single person responsible for accounting and do not have the financial or human resources to manage a reporting and IT system change of this magnitude. Wholesale changes in accounting require a significant investment in time and financial and human resources. Large insurers that once only reported on a statutory basis report the cost to implement current GAAP reporting, in the hundreds of million dollars. This was to add a system that was not significantly dissimilar. The ED represents an entirely new approach to insurance accounting that will come at a significant cost to small insurers at a time when they are being required by state regulators to submit new enterprise risk reports, pay for new risk-focused examinations, comply with enhanced RBC requirements and meet new corporate governance obligations.

The problems that created the financial crisis and drove the desire for convergence were the result of activities by large, systemically significant and interconnected banks and financial services entities. It seems the proposed solutions, including this insurance contracts accounting proposal, will only lead to further industry consolidation, and more "too big to fail" companies. Small companies unable to financially handle all of the new requirements and added costs will have limited options other than merger or dissolution. If FASB adopts this ED, we will very likely see consolidation in our industry -- not a strengthening of competition.

CONCLUSION

NAMIC strongly urges the retention of the current U.S. GAAP standard for property/casualty insurance financial reporting. The property/casualty insurance industry is comprised of diverse insurers of varying size, structure, lines of business and risks. The current U.S. GAAP has worked well and produced decision-useful information to users for decades. The problems with the proposed ED are many and have been set forth in responses to the questions and in this overview of the general and specific concerns. The consequences of ignoring these concerns are serious.
Negatively impacting an entire industry and its customers by changing financial standards is not the goal of this ED.

Thank you for the opportunity to comment.

Sincerely,

Michelle Rogers
Director of Financial and Regulatory Policy
National Association of Mutual Insurance Companies

Attachment: Responses to Questions

CC: Hans Hoogervorst, Chair, International Accounting Standards Board
Ben Nelson, CEO, National Association of Insurance Commissioners
Dale Bruggeman, Chair, NAIC Statutory Accounting Practices & Procedures WG
Mel Anderson, Chair, NAIC International Solvency and Accounting Standards WG
Michael McRaith, Director, Federal Office of Insurance
Steven P. Merriett, Chief Accountant, Board of Governors of the Federal Reserve System
Peter Braumüller, Chair, Executive Committee, IAIS
Paul A. Beswick, Chief Accountant, U.S. Securities and Exchange Commission
ATTACHMENT

RESPONSES TO QUESTIONS

I. Scope

Question 1: Do you agree with the scope and scope exceptions of this proposed guidance, including its applicability to contracts written by noninsurance entities? If not, what types of contracts or transactions also should be included or excluded from the scope and why?

NAMIC does not oppose the conceptual scope of applying a standard to “insurance contracts” as opposed to “insurance entities.” However, the ED includes several scope exceptions that exempt many organizations that write insurance-type contracts from applying the standard. This will not enhance transparency and comparability and will be detrimental to users of the financial statements. Full application of the standard to all agreements that have the elements of “insurance contracts” would be a more comprehensive approach. Consequently, we recommend that the FASB simply retain the current standard and amend the scope so that it applies to all “insurance contracts” and not just “insurance entities” writing insurance contracts.

II. Recognition

Question 2: Do you agree with the requirements included in this proposed Update for when noninsurance components of an insurance contract, including embedded derivatives, distinct investment components, and distinct performance obligations to provide goods or services, should be separately accounted for under other applicable Topics? If not, why?

The requirement to separately account for distinct performance obligations to provide goods or services needs clarification. Property/casualty companies offer a variety of services directly related to the business of insurance that should not be separately accounted for under other Topics. For example, claims handling services are frequently included as part of the product. In addition, some companies offer risk improvement, risk management, and/or loss control services in an effort to promote safer environments for all. Although these services can be purchased separately, they should be considered part of the insurance component as opposed to a noninsurance component. NAMIC seeks clarification that these insurance-related services are part of the insurance contract and not separately accounted for under other applicable Topics.

II. Initial and Subsequent Measurement

Questions for Users

Question 3: Will the proposed measurement model produce relevant information that will help users of an entity’s financial statements make economic decisions? If not, what changes do you recommend and why?
The objective of preparers is to meet the informational needs of users in helping them to understand the financial and operating performance of the company so that they can best assess their risk and reward from transactions with the preparing entity. The ED restrains NAMIC members’ ability to communicate with users for the following reasons:

- The ED is inconsistent with the business model employed by property/casualty insurers;
- The ED would abolish valuation metrics that investors and other users have come to rely on by eliminating decades of company and industry data.
- Under the ED the adequacy of reserves and reserve development information is overly complex and is presented on a different measurement basis than current claims and claims reserving practices.
- The interaction of discounting with an uncertain payout pattern will distort the true liability of the entity, rendering comparisons to other entities less meaningful than the current standard.
- Specifying the liability measurement target at the unbiased probability-weighted mean has several negative impacts for users:
  - Provides no information on company operations related to reserve adequacy/integrity;
  - Severs the connection with statutory accounting, which explicitly mandates conservatism in reserve estimation, with the possible result that entities will carry differing nominal statutory and GAAP reserves with all the associated time, expense and resources needed to manage these two items; and
  - Promotes less adequate reserves and increases possibility of insolvencies.
- The aggregation by “portfolio” reduces information concerning company operations as many entities manage business and measure profitability on a different basis (account basis, profit center, etc.)

Without the historical data and comparisons between entities and with the optionality, complexity and subjectivity in the ED, insurance companies will likely lose the competition for capital from investors and other users. The insurance sector could become uninvestable. For these reasons, NAMIC proposes that the current standard be retained and not rewritten.

**Question 4:** Which aspects of the proposed measurement model most significantly improve the information that will be used in making economic decisions and why?

For short duration contracts, NAMIC does not see any improvement under the proposed measurement model over the current model.

**IV. Measurement Approaches**

**Questions for All Respondents**

**Question 5:** Do you agree that entities should apply different approaches to contracts with different characteristics, described as the building block approach and the premium allocation approach? If not, which model do you think should apply and do you think there should be any changes made to that model?
Although NAMIC does not believe anything needs to be changed under the current U.S. GAAP model, we agree that there should be different models applicable to long-duration (i.e. life insurance) and short-duration (i.e. property/casualty) contracts. Two different models are essential to address the differences between the life and property/casualty business models. However, there are several details about the premium allocation approach model that do not work well for property/casualty insurance contracts under the current ED. We would far prefer the use of the fundamental components of the existing model – like the Unearned Premium Reserve (UPR) and Claim and Claim Expense Reserves (Claim Reserves) – as they are measured and reported in a manner that is very well understood by users and contain no unnecessary complexity. In addition, the alignment between GAAP, Statutory, and Tax reporting allows for the existence of very granular, rich information that investors and analysts use to assess the performance and quality of their investments.

Question 6: Do you agree that entities should be required to apply the premium allocation approach if the coverage period of the insurance contract, considering the contract boundary guidance, is one year or less? If not, what would you recommend and why?

NAMIC agrees with a consistent approach to property/casualty contracts to achieve comparability between preparers. However, we feel the one-year limit will increase diversity in practice for those contracts that are multi-year but have the same characteristics as contracts that are one year or less. In contrast to the one-year bright line, we prefer the current U.S. GAAP treatment, as that approach is more consistent with how the property/casualty insurance business is managed. The current model works well and the Insurance Contracts ED approach is not an improvement. In the absence of principles-based guidance we run the risk of property/casualty insurers applying different accounting models to insurance contracts that have similar characteristics with the exception of the coverage period. See also our response to question seven.

We will address specific concerns with the contract boundary issue in question 9.

Question 7: Do you agree that entities should be required to apply the premium allocation approach if, at contract inception, it is unlikely that during the period before a claim is incurred there will be significant variability in the expected value of the net cash flows required to fulfill the contract? If not, what do you recommend and why?

NAMIC agrees with a consistent approach to property/casualty contracts to achieve comparability between preparers. However, NAMIC would like more clarity on the second factor for applying the premium allocation approach. This language could be read to include all property/casualty contracts under the PAA or to include none of them.

- Property/casualty insurers arguably have very predictable cash flows before a claim is incurred. They receive premiums, they underwrite and issue policies and they pay commissions to agents. Only when a claim is incurred are there variable contractual outflows. Under this analysis all property/casualty contracts would qualify for the PAA.
- On the other hand, property/casualty insurers often learn about storm fronts, wildfires or weather patterns that could increase the “expected” value of net cash flows. If the
“period before a claim is incurred” is defined to include even very short periods of time—days or hours—there is often information available that would result in significant variability in expected cash flows the hours before they occur. However, the accuracy of such predictions is questionable, and the potential loss is quickly replaced by real damage information. Disqualifying all property/casualty contracts for terms longer than one year under this scenario would not make much sense, as this characteristic would apply to contracts for terms less than a year as well.

- Finally, if there is information that is available to a property/casualty insurer that increases the potential risk of the policyholder or of the property insured, there are underwriting and loss control actions that insurers take to address that risk. This PAA factor does not seem to consider action that might be taken to address such risks.

These examples point out some of the confusion surrounding this criterion when applying it to standard short duration contracts. NAMIC supports the use of the current standard that groups contracts consistent with the insurer’s manner of acquiring, servicing, and measuring their profitability over the use of this PAA factor.

V. Portfolio and Contract Boundary

Question 8: Do you agree with the definition of a portfolio of insurance contracts as included in this proposed Update? If not, what do you recommend and why?

NAMIC does not agree with the FASB definition of a portfolio. We would prefer current U.S. GAAP guidance that states contracts should be grouped consistent with the manner of acquiring, servicing, and measuring the profitability of insurance contracts. The proposed definition reduces comparability as it allows for subjectivity in the configuration of portfolios. For example:

- Under the definition in the ED, some insurers could apply a very granular approach to developing portfolios:
  - A portfolio for each rating territory in each state—not priced similarly;
  - Portfolios separating property from casualty risk—they have different periods for release from risk;
  - Portfolios separating personal lines from commercial lines contracts—managed separately;
  - A combination of any or all of the above.

- Other insurers may prefer to keep all property/casualty contracts in a single large portfolio. These differences in applying “portfolio of contracts” lead to diversity in practice and incomparability.

In addition to these issues of inconsistent interpretation of the definition, the term, “portfolio of contracts,” is also inconsistently applied throughout the ED. For example, while “portfolio of contracts” is applied to measure revenues in the cash-flow equation, there are problems with similarly measuring liabilities. Currently, claims and reserves are aggregated on an accident-year basis, not a contract year. In fact the ED references a “portfolio of claims” in sections describing the measurement of liabilities, without defining this alternative portfolio. At the same time the ED requires the use of discount rates relating back to the year of
inception of the contract. The incongruity in the application of a key component of the ED has created concern among NAMIC members.

NAMIC recommends the use of the methodology in the current GAAP to group contracts consistent with the insurer’s manner of acquiring, servicing, and measuring their profitability. If enhancements to current GAAP are required we recommend working within this construct to provide additional segmentation or clarification instead of creating a completely new grouping definition.

If the Board decides to move forward with a portfolio approach, at a minimum, we recommend replacing the ED’s second criterion with the IASB’s second criterion (“are managed together as a single pool”) in the definition of a portfolio. This will allow companies to group their contracts based on their management approach, while providing financial statement users with more reliable and relevant financial information.

Question 9: Do you agree with the requirements included in this proposed Update on contract boundary (that is, the requirements that establish how to identify the future cash flows that will arise as the insurer fulfills its obligations)? If not, what do you recommend and why?

NAMIC is concerned that the contract boundary requirements could preclude premium allocation approach treatment for many traditional property/casualty contracts. For example:

- In the last several years innovative policy benefits offered by property/casualty companies have included features like claim forgiveness, waiver of deductibles and other benefits that carry forward from one contract year to another. This innovation would be stifled by a PAA contract boundary requirement limiting benefits to a more restrictive time period.
- Many commercial insurers offer customers the option to purchase coverage applicable either to claims made during the contract period or to incidents occurring during the contract period. This innovation addressed a commercial insurance availability crisis providing options for customers. If the contract boundary requirements had been in place, these options would have come at a higher price.
- Some commercial policies require premium audits after the end of the contract term to assess actual premium owed. These future cash flows may or may not be included within the required contract boundary. Should this practice be restricted because of a new accounting standard?

NAMIC asserts that accounting standards should not have the effect of restricting innovation. The current accounting standards have evolved with the industry practice and have not diminished innovation. The current GAAP standards should be retained.

VI. Fulfillment Cash Flows

NAMIC does not agree with the proposed fulfillment cash flows as a substitute for existing incurred, ultimate claim estimates. The existing estimates have been developed using a variety of deterministic projection methods. The substitution of the time-tested and validated variety of actuarially accepted projection methods with one stochastic model that has not
been validated for the purpose it is intended to be used for is not supported by property-casualty preparers, investors, or regulators.

Question 10: Do you agree with the types of cash flows that would be included in the measurement of the fulfillment cash flows, including embedded options and guarantees related to the insurance coverage under existing insurance contracts that are not separated and accounted for as embedded derivatives? If not, what cash flows do you think also should be included or excluded and why?

NAMIC does not disagree with the inclusion of embedded options and guarantees to the extent they exist, however, these contractual elements are most often found in life insurance and investment contracts and not short-duration property-casualty insurance contracts.

Question 11: Do you agree that the assumptions used in the measurement of the fulfillment cash flows should be updated each reporting period? If not, what do you recommend and why?

NAMIC believes this requirement would exponentially increase the costs and resources needed to make the numerous “subjective” judgments and calculations necessary to complete financial reporting. Current GAAP guidance should be retained for short-duration contracts as it is well understood by preparers and users alike and has been time tested over numerous economic and insurance cycles. The proposed requirement to discount “uncertain” cash flows would significantly increase the resources required to prepare financial reports and erode decision-useful information.

Question 12: Do you agree that the fulfillment cash flows for contracts measured using the building block approach and the liability for incurred claims for contracts measured using the premium allocation approach should be based on an explicit, unbiased, and probability-weighted estimate (that is, the mean) of the future cash flows, as of the reporting date, expected to arise as the entity fulfills the contract, adjusted to reflect any contractual linkage between the contract and any underlying assets? If not, what do you recommend and why?

NAMIC does not agree with the FASB proposal of measuring the liability for incurred claims under the PAA using an “unbiased, probability-weighted estimate of future cash flows.” The proposed method is inconsistent with current property/casualty reserving practices as well as statutory accounting practices. The current method of calculation under ASOP 43 (used for both U.S. GAAP and statutory accounting) results in a “conceptual mean” and not an “unbiased” statistical mean. A stochastic probabilistic methodology is not part of the current practice for setting reserves. The current practice considers the information learned about each claim during each reporting period (medical developments, legal developments, claim payments etc.) and overlays a deterministic actuarial central estimating (ACE) process. The measurement of ACE relies on a mix of models and judgments such that the reserve recorded is a “conceptual” mean as opposed to a “statistical” mean. There is no single method or model that dominates under the ACE process.

The ED would require an actuarial methodology more consistent with life insurance mortality risks. While stochastic methods are used in property/casualty modeling for purposes of reinsurance or overall risk management, they have not proven to produce a more accurate reserve level for financial reporting and are not widely accepted by the property/casualty actuarial profession. The number of assumptions involved create an unacceptable error.
factor. Conversely, the current reserve practice has been around for over 30 years and has proven to be valuable for all users. The current approach implicitly considers the uncertainty inherent in the estimates and produces a range for management to consider in making final reserve-setting decisions. Just like deterministic methods, stochastic approaches require a number of assumptions to perform this sort of reserve analysis.

In addition, requiring by accounting standard a specific method for insurance reserving seems incongruous with the role of financial reporting. If there is a perceived need to require changes in industry practice, insurance regulators and their actuaries are most well-positioned to propose such changes.

NAMIC urges that FASB resist the pressure to create a single measurement model for the BBA and the incurred claims liability under the PAA. The current standard FASB developed and evolved over decades allows insurers to apply the preferred property/casualty reserving practices, and is favored by regulators and rating agencies.

Question 13: Do you agree with the approach in this proposed Update to recognize changes in estimates of cash flows (other than the effect of changes in the liability arising from changes in the discount rates) in net income in the reporting period? If not, what do you recommend and why?

NAMIC does not agree with the fulfillment cash flows, as set forth in the ED, as a substitute for existing incurred, ultimate claim estimates developed using a variety of deterministic projection methods. Applying discounting to “uncertain” cash flows erodes decision-useful information and produces more uncertain estimates of ultimate liability. Although NAMIC does not agree with the proposed requirements to determine the cash flows and to discount, we do agree that changes in estimates of cash flows (other than changes due to discounting) should be recognized in net income in the reporting period.

VII. Discount Rates and Discounting

Questions for All Respondents

Question 14: Do you agree that the discount rates used by the entity for nonparticipating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

Short-duration insurance contracts should not be discounted because the uncertainty and variability of cash flow patterns produce liability estimates that are less useful than nominal ultimate loss estimates. While discounting is good economic theory, applying it to uncertain cash flows provides no value to users and does not improve comparability. There is already subjectivity in the estimate – adding subjectivity on top of subjectivity is not beneficial.

NAMIC does not agree with the FASB proposal to require the discount rate to reflect the characteristics of the insurance contract liability. The options to calculate these characteristics and the appropriate rate are overly complex. First, it is a significant challenge to identify a “market” rate for liabilities that only derive market value from the private market. One approach in the ED – the bottom up approach – requires starting with the risk-free rate of return and adding a liquidity premium to determine the discount rate. The problem with
this approach is there is no standardized method for determining the illiquidity premium. Under the other option -- the “top-down” approach -- an entity would start with the yield curve that either reflects the actual portfolio of assets or a reference portfolio with similar characteristics to the insurance contract liabilities. The entity would then adjust (subtract) the rate for any market risk premiums, such as expected or unexpected credit losses as well as adjust for the timing of the liability cash flows. It will be arduous for users to compare entities under this complex and varied system.

If required to discount, NAMIC suggests a practical expedient in the form of a composite rate as opposed to the aforementioned bottom-up or top-down approaches. This rate, perhaps a AA corporate bond rate or a pre-determined risk-free rate, could apply to all liabilities on a period basis. Although neither of these approaches would contain all of the characteristics inherent in the proposed discount rate formula, either approach will inherently incorporate a risk adjustment in the amount and will result in higher reserve. Most important, a specific, indexed rate would reduce the number of variables (rate and period) needed and reduce the complexity, and practice diversity in determining the discount rate.

Question 15: For contracts measured using the premium allocation approach, do you agree that an entity should discount the liability for incurred claims? Do you agree that an entity should be allowed to elect not to discount portfolios when the incurred claims are expected to be paid within one year of the insured event? Why or why not? If not, what would you recommend and why?

NAMIC disagrees with the requirement under the premium allocation approach to discount the liability for incurred claims. Short-duration insurance contracts should not be discounted because the uncertainty and variability of cash flow patterns produces liability estimates that are far less useful than nominal ultimate loss estimates. While discounting is good economic theory, applying it to uncertain cash flows provides no value to users and does nothing to improve comparability. There is already subjectivity in the estimate — adding subjectivity on top of subjectivity is not beneficial.

The variability associated with the interaction of the discount rate and cash flow pattern will add uncertainty to the estimation of the liability. Loss payout patterns are particularly variable for short-duration property/casualty contracts. The increased uncertainty that the FASB is proposing in the estimation of the liability will increase earnings volatility, decrease comparability, and create difficulties for users in determining the adequacy of the liabilities. It is also excessively complex which will require system changes and tracking of multiple additional variables.

There is also uncertainty surrounding the application of the definition of a portfolio. For example, while “portfolio of contracts” is applied to measure revenues in the cash-flow equation, there are problems with similarly measuring liabilities. Currently, claims and reserves are aggregated on an accident-year basis, not a contract year. In fact the ED references a “portfolio of claims” in sections describing the measurement of liabilities, without defining this alternative portfolio.

In response to the second inquiry about the practical expedient for claims expected to be paid within one year, if FASB decides to proceed with discounting for incurred claims under the PAA, insurers subject to the criteria should be required to use undiscounted reserves —
not be allowed to elect whether they want to discount or not. However, there are serious questions about the adequacy of the practical expedient, “within one year of the insured event” and about the impact on package policies that may include claims paid within a year and claims not paid within a year.

- State law and different insurance contractual provisions provide a number of different interpretations of when an insured event has occurred. Under an “occurrence based” policy this could be when the event causing the claim manifested itself, when the incident causing damage began or there could be a continuous trigger creating a new claim every day. If the policy is written on a “claims made” basis the insured event can be when the claim is filed. The variety of interpretations of “one year after the insured event” will create further practice diversity and additional complexity in the situation.
- At times claims have both a property and a casualty element under the same policy. Casualty claims often have a longer payment period than property claims. Frequently casualty claims remain open beyond one year to incorporate all medical expenses. The approach that is required under the ED would mean that these policies that cover both property and casualty would not ever be exempted from discounting regardless of the timing of the payments.

The preferred approach is to continue the current GAAP standard for short duration contracts as the details and interpretation issues have been resolved over decades. In the event, FASB proceeds with the approach set forth in the ED, we recommend that the practical expedient exempting short duration contracts from claims discounting be extended to those with claims settled within five years after the claim is filed and that the exemption apply at the policy level.

**Question 16:** Do you agree that an entity should segregate the effects of underwriting performance from the effects of changes in discount rates (which would reverse over time) by recognizing changes in the present value of the fulfillment cash flows due to changes in the discount rates in other comprehensive income? If not, do you think that the effect of changes in the discount rates should be presented in net income? Please explain your reasoning.

Short-duration insurance contracts should not be discounted because the uncertainty and variability of cash flow patterns produces liability estimates that are less useful than nominal ultimate loss estimates. While discounting is good economic theory, applying it to uncertain cash flows provides no value to users and does nothing to improve comparability. There is already subjectivity in the estimate – adding subjectivity on top of subjectivity is not beneficial.

Although NAMIC disagrees with the concept of discounting, we agree with the notion of segregating the effects of underwriting performance from the effects of changes in discounts rates by reporting the changes in discount rates in other comprehensive income. Property and casualty companies value the ability to analyze underwriting performance, and by separating the effects of changes in discount rates from net income, companies can continue to perform this type of analysis. Although conceptually it makes sense to separate these two functions, it is not practical. Tracking and retaining old accretion discount rates will require significant systems changes and updating quarterly will be unnecessarily burdensome. This
is yet another reason why we are fundamentally opposed to discounting the measurement of claim reserves.

**Question 17:** Because the proposed guidance includes the approach under which changes in the insurance liability arising from changes in the discount rates should be recorded in other comprehensive income, do you think that a test should be required to trigger recognition in net income of some or all of the amounts in accumulated other comprehensive income (that is, a loss recognition test based on asset-liability mismatches)? Why or why not?

Although we can conceptually understand the merits of this concept similar to “other than temporary” impairment, there is minimal benefit to be gained. This approach also adds an additional layer of complexity and significant cost to an already complex model. Since the amount will unwind over time, we believe that it is temporary and an additional test should not be required.

**Questions for Preparers and Auditors**

**Question 18:** Do you agree that the method for calculating the discount rates should not be prescribed? Is the proposed guidance on determining the discount rates understandable and operable? If not, what do you recommend?

We reiterate that short-duration insurance contracts should not be discounted in the first place because the uncertainty and variability of cash flow patterns produces liability estimates that are much less useful than nominal ultimate loss estimates. The proposed guidance is not understandable, it is overly complex, and it will lead to diversity in practice.

NAMIC does not agree with the FASB proposal to require the discount rate to reflect the characteristics of the insurance contract liability. The options to calculate these characteristics and the appropriate discount rate are overly complex. First, it is a significant challenge to identify a “market” rate for liabilities that only derive market value from the private market. One approach in the ED – the bottom up approach -- requires starting with the risk-free rate of return and adding a liquidity premium to determine the discount rate. The problem with this approach is there is no standardized method for determining the illiquidity premium. Under the other option -- the “top-down” approach -- an entity would start with the yield curve that either reflects the actual portfolio of assets or a reference portfolio with similar characteristics to the insurance contract liabilities. The entity would then adjust (subtract) the rate for any market risk premiums, such as expected or unexpected credit losses as well as adjust for the timing of the liability cash flows. It will be arduous for users to compare entities under this complex and varied system.

If required to discount, NAMIC suggests a practical expedient in the form of a composite rate as opposed to the aforementioned bottom-up or top-down approaches. This rate, perhaps a AA corporate bond rate or a pre-determined risk-free rate, could apply to all liabilities on a period basis. Although neither of these approaches would contain all of the characteristics inherent in the proposed discount rate formula, either approach will inherently incorporate a risk adjustment in the amount and will result in higher reserve. Most important, a specific, indexed rate would reduce the number of variables (rate and period) needed and reduce the complexity, and practice diversity in determining the discount rate.
Question 19: Do you agree that interest expense generally should be based on the discount rates determined at the date the portfolio of contracts was initially recognized? Why or why not? If not, what do you recommend?

According to guidance, the interest accretion rates shall be the same as the discount rates that were initially applied at inception of the contract. This conflicts with the Basis of Conclusions (BC355) which states the accretion rates should be based on the initial rates when the portfolio of contracts was recognized. If the intent is to base the accretion rate at the level of portfolio of contracts, it will be difficult to determine what rate to choose when contracts within the portfolio have different inception dates. Equally difficult to implement and potentially impossible to track would be an interest accretion rate based on the discount rate chosen on an individual contract level.

If required to discount, NAMIC suggests a practical expedient in the form of a composite rate as opposed to the aforementioned bottom-up or top-down approaches. This rate, perhaps a AA corporate bond rate or a pre-determined risk-free rate, could apply to all liabilities on a period basis. Although neither of these approaches would contain all of the characteristics inherent in the proposed discount rate formula, either approach will inherently incorporate a risk adjustment in the amount and will result in higher reserve. Most important, a specific, indexed rate would reduce the number of variables (rate and period) needed and reduce the complexity, and practice diversity in determining the discount rate.

Question 20: Do you agree that upon any change in expectations of the crediting rates used to measure the insurance contract liability for insurance contracts with discretionary participation features, the interest accretion rates should be reset in a manner that recognizes any changes in estimated interest crediting and related expected cash flows on a level-yield basis over the remaining life of the contracts? If not, what do you recommend?

We do not believe this question applies to property/casualty contracts, however, the definition of “Participating Insurance” is very broad. The Basis for Conclusions seems to confirm the intention of the Board to apply these provisions to life-insurance related participation agreements only. We request clarification that this language does not apply to property/casualty mutual insurance company discretionary dividends to policyholders or other property/casualty loss history-related contractual participation clauses. This will help preparers and auditors accurately interpret the standard.

VIII. Margin for Contracts Measured Using the Building Block Approach

Question 21: Do you agree that an insurer should not recognize a gain at initial recognition of an insurance contract (such a gain would arise when the expected present value of the cash outflows is less than the expected present value of the cash inflows) but, rather, should defer that amount as profit to be recognized in the future? Why or why not?

- N/A
Question 22: Do you support using a one-margin approach, as is included in this proposed
guidance, or an explicit risk adjustment and a contractual service margin (as the IASB proposes)?
Please explain the reason(s) for your view.

- N/A

Question 23: If you support a risk adjustment and a contractual service margin, do you agree with
the IASB’s approach to adjust the contractual service margin for changes in estimates of cash flows?
Why or why not? Do you agree with the IASB’s approach to not specify acceptable approaches to
determine the risk adjustment? Why or why not?

- N/A

Question 24: Do you agree that a loss at initial recognition of a portfolio of insurance contracts
should be recognized immediately in net income (such a loss would arise when the expected present
value of the cash outflows exceeds the expected present value of cash inflows)? Why or why not?

No. First we do not agree that an entity should discount the reserves (i.e., the liability for
remaining coverage and liability for incurred claims) calculated under the PAA. Therefore,
when facts and circumstances indicate that a portfolio of contracts may be onerous, the
onerous contract test should be performed on an undiscounted basis, with the option to
include expected investment income. This approach is consistent with current U.S. GAAP
and considers a revenue stream that is integral in determining the pricing and profitability
of an insurance contract. The exclusion of investment income under an onerous contract test
may result in the recognition of expected losses for insurance contracts that are actually
profitable, leading to confusion and information that is not useful to users of the financial
statements.

If the Board decides to retain the requirement to require discounting of the liability for
remaining coverage and liability for incurred claims, we continue to have concerns with the
impact of expected investment income on the onerous contract test. We acknowledge that
discounting the fulfillment cash flows may have some offsetting impact to an entity’s
inability to include expected investment income. However, we believe that the proposed
methods of determining the discount rate used in determining the present value of fulfillment
cash inflows will not capture the complete effect of expected investment income.

Related to the onerous contract test, we do not agree with example 13 within the ED, which
requires the consideration of potential catastrophic events in an onerous contract test. The
uncertain nature of a catastrophic event’s occurrence, severity, and timing are factors that
we believe would not be prudent for a company to forecast and record an expected loss
when the catastrophic event has not yet incurred. In addition, recording an expected loss for
such a significant and uncertain event before it has occurred, adversely affected the
policyholder, or before the loss could be practically estimated would not provide a faithful
representation of an insurance contract’s liability and is inconsistent with the “incurred loss”
short-duration contract model.

Example 13 included in the ED also provides that upon establishment of an onerous contract
loss for an expected catastrophic event, it is determined that the catastrophic event did not
occur. As a result, the example provides that the onerous contract loss reserve would remain, with disclosure of updated assumptions. We have concern with this example, as it does not provide a faithful representation of the insurance liability at the end of the reporting period. Recording a significant loss for an event that did not occur would be inaccurate. Such information would lead to confusion and mislead users of the financial statements.

The example is even more concerning considering the impact on the ceded reinsurance component of property/casualty contracts. This would further distort comparability in financial statements as each preparer attempts to speculate on the ultimate impact to their ceded reinsurance programs and guess the timing and location of a natural disaster. This is to say nothing of the speculation that would be imposed on the Reinsurance industry. Comparability between the financial statements of Reinsurers would be lost. This is not just a hypothetical situation as there have been several times, over the past 10 years or so, that industry-significant catastrophes have been impending or have very recently occurred as the financial statements are being closed for the third quarter.

The current U.S. GAAP within ASC 855 (Subsequent Events) provides guidance for the accounting and reporting of (1) additional information obtained or (2) significant events occurring subsequent to the reporting date. For example, ASC 855-10-55-2 provides a specific example for a natural disaster (e.g., hurricane) that occurs after the reporting date. ASC 855 (Subsequent Events) provides that a natural disaster occurring subsequent to a reporting date would not be recorded within the financial statements, but included as a disclosure (i.e., nonrecognized subsequent event). To alleviate the identified concerns within example 13 of ED discussed above, we propose that FASB maintains the practice within current U.S. GAAP, which requires losses to be recorded for catastrophic events when the event has occurred, the event adversely affects the policyholder, and the loss can be reasonably estimated. Catastrophic events occurring after the reporting date will continue to be adequately accounted and reported for under ASC 855 (Subsequent Events).

**Question 25:** Do you agree with the proposed method(s) of recognizing the margin (that is, as the entity is released from risk under the insurance contracts as evidenced by a reduction in the variability of cash outflows)? If not, what do you suggest and why?

- N/A

**Question 26:** Do you agree that interest should be accreted on the margin and therefore affect insurance contract revenue? If not, why?

- N/A

**Question 27:** Do you agree that if the expected cash outflows (including qualifying acquisition costs) of a portfolio of insurance contracts will exceed the expected cash inflows, an entity should recognize the remaining margin immediately in net income? Why or why not?

- N/A
IX. Acquisition Costs

Questions for Preparers and Auditors

Question 28: Do you agree that the direct acquisition costs presented with the margin should include only the costs directly related to the entity’s selling efforts that result in obtaining the contracts in the portfolio and that all other acquisition costs should be recognized as expenses when incurred? If not, what do you recommend and why?

NAMIC favors the IASB position that acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and should include those costs that vary with and are primarily related to the acquisition of insurance contracts whether successful or not. Specifically, all direct acquisition costs, including unsuccessful efforts, are costs that arise directly from an insurance contract or can be attributed to a contract on a reasonable and consistent basis. Such costs are factored into the profitability of insurance contracts. We recommend convergence with the IASB approach on acquisition costs.

Question 29: Do you agree that the measurement of the margin for contracts measured using the building block approach and the liability for remaining coverage for contracts measured using the premium allocation approach should be reduced for direct acquisition costs incurred? If not, what do you recommend?

- See response to question 28.

Question 30: Do you agree that an entity should recognize acquisition costs as an expense in net income in the same pattern that it recognizes the margin for contracts measured using the building block approach or in the same pattern that it reduces the liability for remaining coverage under the premium allocation approach? If not, why not?

- See response to question 28.

X. Insurance Contract Revenue

Questions for All Respondents

Question 31: Do you agree that users of financial statements would obtain relevant information that faithfully represents the entity’s financial position and performance if, in net income, for all insurance contracts, an entity presents insurance contract revenue and incurred expenses, rather than only information about changes in margins (that is, the net profit)? If not, why not?

We do not represent the users of financial statements, but the question seems to inquire whether the current system works well and provides decision-useful information. We would agree that the current U.S. GAAP treatment of property/casualty contract revenues and incurred expenses is more consistent with how companies manage property/casualty insurance business. The current model works well and the Insurance Contracts ED approach is not an improvement.
Question 32: Do you agree that, for all contracts, revenue should exclude any amounts received that an entity is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs and that expenses should exclude the corresponding repayment of those amounts? If not, what do you recommend? Please specify whether your view depends on the type of contract.

NAMIC does not agree with the language in the guidance that requires an entity to exclude from revenue any amounts received that an entity is obligated to pay to policyholders or their beneficiaries. There are too many different scenarios and regulatory restrictions on insurance rates and premiums that create challenges under this approach. For example:

- In some states for certain lines of business (e.g. Wisconsin workers’ compensation) insurance entities are mandated to use the state established rates, but compete by offering "dividend plans." Some dividend plans offer a guaranteed dividend regardless of performance, and others are tied to aggregate performance levels. It would be unfortunate to force these entities to segregate out possible estimated future dividend payments when it may not be clear the entity will declare a dividend.

- Also premiums are regulated by state insurance authorities in most states and cannot include rebates or return of premium unless they are benefits under the policy or the policyholder cancels the policy before the contract expires. The proposed language would seem to ignore this legal requirement by offsetting such amounts.

- Some property/casualty insurers provide loyalty bonuses to long-standing customers as well. These bonuses may be based on contractual obligations from prior contract years. This practice may not be intended by the question, but the obligation may exist from a prior year and could create confusion to those interpreting the ED.

Question 33: For contracts measured using the premium allocation approach, do you agree that if the contract has a financing component that is significant to the contract, an entity should adjust the liability for remaining coverage to reflect the time value of money and recognize the accretion of interest with insurance revenue? Do you agree with the practical expedient that an entity should not be required to reflect the time value of money in measuring the liability for remaining coverage (that is, if the entity expects, at contract inception, that the time period between when the policyholder pays all or substantially all of the premium and when the entity provides the corresponding part of the coverage is one year or less)? If not, what do you recommend and why?

No. Consistent with our response for discounting of the liability for incurred claims in question 15, we do not believe that it will result in decision useful information for users of the financial statements.

Questions for Preparers and Auditors

Question 34: For contracts measured using the building block approach, does this proposed Update contain sufficient guidance on how to determine insurance contract revenue in accordance with the principle that it should be allocated between reporting periods as performance obligations are satisfied over time (that is, to allocate consideration between periods by reference to the relative value of the services provided in each period)? If not, explain what additional guidance is necessary.
XI. Participating Contracts

**Question 35:** Do you agree that participation features that are contractually dependent on the performance of other assets or liabilities of the insurer or the performance of the entity itself should be measured on the same basis used to measure the underlying items and changes in the measurement should be presented in the same statements (that is, net income or other comprehensive income)? Do you agree that this approach should be limited to only participating features for which the amount of the performance of the underlying items passed through to policyholders is contractually determined and not extended to participating features that allow an entity discretion about the amount of the performance of the underlying item to pass through to the policyholders?

Yes, we agree and request the clarification set forth below.

We do not believe this question applies to property/casualty contracts, however, the definition of “Participating Insurance” is very broad. The Basis for Conclusions seems to confirm the intention of the Board to apply these provisions to life insurance-related participation agreements only. We request clarification that this language does not apply to property/casualty mutual insurance company discretionary dividends to policyholders or other property/casualty loss history-related contractual participation clauses. This will help preparers and auditors accurately interpret the standard.

XII. Reinsurance

**Questions for All Respondents**

**Question 36:** Do you agree that a cedant should record a margin if the expected present value of the cedant’s future cash inflows exceed the expected present value of the cedant’s future cash outflows (thus prohibiting the recognition of a gain at inception upon entering into a reinsurance arrangement) for (a) retrospective reinsurance contracts accounted for using either the building block approach or the premium allocation approach and (b) prospective reinsurance contracts accounted for using the building block approach? If not, what do you recommend and why?

NAMIC agrees with the FASB’s approach that a cedant should record a margin for prospective reinsurance contracts accounted for using the building block approach. This is consistent with the application of the building block approach in other sections of the ED. However, NAMIC does not agree with the recognition of a margin for reinsurance assumed. Under current U.S. GAAP, insurers already factor in the uncertainty in the estimation of liabilities relating to past events when they set up IBNR reserves. This is a conservative and prudent approach that reduces underwriting income because any gain is offset by the IBNR reserve. Setting up a margin would render IBNR useless and at the same time would add ambiguity to users and preparers of the schedule P, all while reducing comparability. We recommend that FASB retain the current standards for reinsurance assumed. If the standard were to be adopted as is, we ask FASB to clarify whether IBNR can be treated as though it represents a margin, or if a separate liability called margin for reinsurance should be created.
Questions for Preparers and Auditors

Question 37: Do you agree that a cedant should estimate the fulfillment cash flows (including the ceded premium) for a reinsurance contract using assumptions consistent with those used to measure the corresponding fulfillment cash flows for the underlying insurance contract or contracts, without reference to the margin on the underlying contracts? If not, what would you recommend and why?

Yes, we agree with this approach and encourage relevant sections of the ED to be revised that do not maintain consistent measurement of reinsurance contracts ceded and the underlying contracts.

XIII. Insurance Contracts Acquired in a Business Combination

Questions for All Respondents

Question 38: Do you agree that entities should record a loss at the acquisition date in the amount by which any excess of the asset and liability balances related to insurance contracts measured in accordance with the guidance in this proposed Update exceeds the fair value of those assets and liabilities? Do you agree that entities should record a margin (not an immediate gain) for the amount that the fair value of the asset and liability balances exceeds those assets and liabilities measured in accordance with the guidance in this proposed Update? If not, do you think an entity should instead increase or decrease goodwill for the differences between the fair value and the measurement in accordance with the guidance in this proposed Update on those assets and liabilities? Why or why not?

NAMIC proposes that companies should not record a loss in this scenario. Under current GAAP, companies establish an identifiable intangible asset called value of business acquired (“VOBA”). In most business combinations, if the purchase price cannot be allocated to VOBA, a positive balance is recognized in goodwill. Consequently, the treatment of this issue under the ED is inconsistent with other business combination guidance. The current GAAP practice is more representative of the economics of the transactions.

Members report that measurement in accordance with the ED could result in an immediate loss for most business combinations. New acquisitions are made with the goal of profit and growth, so this counterintuitive treatment under the ED is a significant issue for most insurance entities.

We recommend recording goodwill in alignment with the IASB ED. At a minimum, if the FASB does not support the IASB’s position, we respectfully urge the FASB to reconsider the concept of VOBA and allow for the deferral and amortization of this amount consistent with current practice.

XIV. Contract Modifications

Questions for Preparers and Auditors
Question 39: Do you agree that for a substantial modification (a) an entity should recognize a gain or loss as the difference between the measurement of the modified contract using the current entity-specific price that the entity would hypothetically charge the policyholder for a contract equivalent to the new contract and the carrying amount of the existing contract and (b) that the carrying amount of the existing contract should be derecognized? If not, what do you recommend?

It is difficult to answer this question without understanding the unit of account on which the measurement is based. According to the guidance, companies measure and track cash flows on a portfolio level, and modify and derecognize contracts at the individual contract level. Under these conditions, companies will find it challenging to apply the guidance. This is yet again another example where the definition of a portfolio is inconsistently applied. NAMIC recommends the use of the methodology in the current standard for grouping contracts consistent with the insurer’s manner of acquiring, servicing, and measuring their profitability.

XV. Presentation

Questions for All Respondents

Question 40: Do you agree with the presentation requirements included in this proposed Update? If not, what would you recommend and why?

NAMIC does not agree with the presentation requirements proposed in this update. The presentation set forth under the current guidance is superior and produces useful information for users, regulators and preparers. The requirement to discount “uncertain” cash flows opens the door for diversity in practice rendering the comparison of financial statements useless. The current guidance for short-duration contracts is well understood by users and preparers and has been time-tested through numerous economic and insurance cycles. The proposed guidance and presentation will have the effect of destroying all comparability to the wealth of historic earnings information accumulated under a well-understood accounting regime. The proposal is not an improvement over the current standards.

XVI. Disclosure

Questions for All Respondents

Question 41: Do you agree with the disclosure requirements included in this proposed Update? If not, which disclosure requirement(s) would you change and why? Are there any additional disclosures that would provide decision-useful information and why? Do you think that any of the disclosure requirements included in this proposed Update would not provide decision-useful information and should not be required? If so, which ones and why?

NAMIC does not agree with the disclosure requirements proposed in this update. We feel that for short-duration contracts the new disclosure requirements will provide less decision-useful information to users than the current US GAAP guidance. The objective of disclosure requirements should be to enable users of financial statements the ability to understand the amount, timing, and uncertainty of future cash flows arising from insurance contracts. The
proposal if implemented would not accomplish this objective. The failure to meet this objective derives from the complexity that is inherent throughout the draft. For example the disclosure requirements surrounding the onerous contract test is so complex that users will find it difficult to unwind discounted liability estimates into understandable nominal values. NAMIC would prefer to retain the current GAAP guidance for short-duration contracts.

As the disclosure become more complex and voluminous, we have serious concerns relating to confidential or proprietary information being disclosed. We believe that several of the disclosures require sensitive competitive information and by disclosing it, competitors will benefit. For this reason, we believe companies will either make their disclosures so limited that they are not useful or disclose so much that they will be negatively impacted. Specifically, our concerns relating to the confidential or proprietary information are centered on the disclosure requirements contained in the ED in sections 834-10-50-24, 834-10-50-25, 834-10-50-29, and 834-10-50-3.

Finally, we disagree with the ED’s requirement that sensitivity analysis should be disclosed in the financial statements. We believe that the sensitivity analysis creates information that can be misapplied and misunderstood. Specifically, our concerns are focused on the disclosure requirements contained in the ED in sections 834-10-50-31 and 834-10-50-34. If the FASB decides to retain these disclosures, we suggest that all sensitivity analysis should be in narrative form and at a high enough level so the information will be useful to and easily understood by the users of the financial statements. We believe that the level should be consistent with the measurement approach (i.e., group all insurance contracts accounted for under the PAA and group all insurance contracts accounted for BBA).

XVII. Effective Date and Transition

Questions for Preparers and Auditors

Question 42: The Board will establish the effective date of the requirements when it issues the final amendments. However, the Board is interested in determining the key drivers affecting the timing of implementation. What are those key drivers? How do those drivers affect the time it will take to implement this proposed guidance?

NAMIC feels that the requirement to discount short-duration contracts is the largest single driver that will affect the timing of implementation. Issuers of short-duration contracts neither have the expertise to determine appropriate yield curves for the various portfolios, nor do they have the systems in place to maintain discount rates at inception or apply discounting on the scale required by the proposed guidance. The current business model for short-duration property/casualty issuers is inconsistent with a discounting requirement.

Another key driver that will affect the timing of implementation is the unbiased probability-weighted cash flow mean analysis. Reserving processes will have to change significantly from the current deterministic practice to the more complex stochastic reserving approach. Many entities will need to hire and train more actuaries or hire consultants in order to comply with the proposed guidance. Additionally, because of the radical changes being proposed, and the complete overhaul that most entities will have to perform, several reporting periods would need to be tested so that the new process can be fully vetted.
Other key areas that will affect the timing of implementation are portfolios will have to be defined, aggregated and tested. Systems and procedures to do so will need to be developed. Internal Controls will need to be redeveloped. More accounting resources would have to be acquired and personnel trained. In total, it will take several years for most entities to be in a position to implement the proposed guidance. It would not be unreasonable to have a six to eight year transition period.

Of course, NAMIC would prefer the current GAAP guidance for short-duration contracts as it is well understood by users and preparers and is time tested. If a few additional disclosures or adjustments were required to make the current standard even better, the implementation time and costs would be fairly minimal.

**Question 43:** Do you think the effective date should be the same for both public and nonpublic entities? Do you think the effective date should be the same for regulated insurance entities and other entities that issue insurance contracts within the scope of this proposed guidance? Why or why not?

NAMIC does not believe the guidance for short-duration contracts should be implemented. If, however, the proposal were adopted we recommend FASB provide implementation dates that are adequate depending on the type of preparers. Larger companies will have more resources to implement the proposal and to adapt more quickly than smaller companies. We believe the implementation strategy should factor in the size of the company.

In addition, we agree that the effective date of proposed guidance should be different for public and nonpublic entities, as the difficulty to implement the guidance often will vary by entity. Some groups include public entities that are consolidated by nonpublic entities. In these cases, we believe companies should have the ability to adopt the ED for the public entities, at the same time it is required for the nonpublic entities. This will allow for streamlined reporting and implementation activities and less confusion for financial statement users of both sets of financial statements.

**Question 44:** Do you agree that the practical expedients relating to transition included in this proposed guidance are sufficient for retrospective application (that is, are the transition provisions in this proposed guidance operable)? If not, what would you recommend and why?

The best practical expedient to adopt for short-duration contracts would be to retain the current GAAP guidance and exempt issuers of short-duration contracts from the scope of the proposed guidance.

**Question 45:** For business combinations that occurred before the transition date, is the requirement included in this proposed Update on reallocating the fair value of the asset and liability balances related to insurance contracts between the expected fulfillment cash flows and the margin operable? Why or why not? If not, what would you recommend and why?

- N/A

Questions for Users and Auditors
Question 46: Do you agree that the proposed approach to transition would provide users of financial statements with relevant information that faithfully represents the entity’s financial position and performance in a way that appropriately balances comparability with verifiability? Why or why not?

Concerning short-duration contracts, the proposed guidance as a whole provides less relevant information about an entity’s financial position than current guidance. The guidance itself is not at all comparable to historic financial statements and destroys a wealth of useful historic information. The transition period will neither erase nor ease these failings.

XVIII. Costs and Complexities

Questions for Preparers

Question 47: Describe the nature of the incremental costs of adopting the guidance in this proposed Update, distinguishing between one-time costs and ongoing costs. Explain which aspects of the guidance in this proposed Update are driving those costs and include ideas to make the proposal more cost effective.

NAMIC members see little benefit in the revised standards. The benefits, if any, of the new standards have not been clearly articulated, but the costs associated with these changes are very evident. It is not difficult to conclude that the costs outweigh the benefits. A few of the key costs are highlighted below, but it is critical to note that the price we will pay goes beyond dollars and cents. The cost will be suffered in the loss of the rich body of historical data. It will be felt by small companies and their customers. It will be in the uncertainty created by the changes. It is not often that an accounting standard can have such an impact, but the changes are so significant that they have risen to that level. Below is a discussion of the key implementation costs and expansion on a few of the unintended consequences.

a. Cost of Converting to Unbiased Probability-Weighted Cash Flow Reserving

For issuers of short-duration contracts, the requirement to move to unbiased probability-weighted cash flow reserving is the item which will increase cost the most and provide the least benefit. For implementation, companies will have to hire more actuaries, accountants and systems experts or engage more consultants because the reserving process itself will require a complete overhaul for most property/casualty insurers.

- Currently, reserving processes focus on determining the ultimate nominal loss and, from that, the appropriate loss reserve to book. In other words, the focus is on the ultimate loss and not the timing or amounts of incremental losses. Property-casualty actuaries will need to develop, test and validate new methodologies to address these reserving estimation requirements.
- More accounting experts will be required to track the many new variables introduced, develop audit controls, train and explain the complex drivers of financial results to users.
- Companies will need to change IT systems and processes to shift to a cash flow approach. More information technology systems, software and employees will be
required to design, monitor and establish controls for the many new processes and track the many new variables required by the proposed guidance.

Even after implementation, companies will continue to incur added costs to properly apply the proposed guidance and reestablish the significance of the data reflected by the new information produced. Additional investment professionals will be required to explain to users the drivers of financial results obscured by the complex accounting procedures. Independent auditors will be far more costly as they will need to audit not only the financial reporting but the actuarial processes implemented. The need for talent to address the reserving changes will be not only a transitional, but an ongoing and expensive cost consideration. The exact costs are very difficult to determine with accuracy, but it will likely be much greater than anyone is currently anticipating. The costs will be very, very significant, indeed.

Another significant, but less measureable, cost related to the revised reserving methodology is the loss of the connection between GAAP and statutory accounting. Statutory accounting explicitly mandates conservatism in reserve estimation so it is unlikely that insurance regulators and the NAIC SAPWG will adopt the revisions set forth in the ED. The loss of the similarities between the two systems could result in entities carrying differing nominal statutory and GAAP reserves. To maintain both reserve methodologies will cost time, expense and resources as well.

Ideas to Make Proposal More Cost Effective

The best solution is to allow property/casualty companies to continue to establish reserves using the current Ultimate Best Estimate approach and not a probability-weighted cash flow approach. In the introduction to the ED, FASB iterates concerns they were trying to address in the proposed standard. One of those concerns was user interest in actuarial reserve ranges. Requesting high level disclosure of those ranges within the current U.S. GAAP standards for insurance would be much less disruptive than requiring companies to adopt a completely new actuarial methodology for reserving.

b. Cost to Determine Appropriate Discount Rates

NAMIC stresses that the details of the requirement to discount short-duration contracts will also significantly affect cost. The current business model for short-duration property/casualty insurers is inconsistent with a discounting requirement. Issuers of short-duration contracts have neither the expertise to determine appropriate yield curves for the various portfolios, nor the systems in place to maintain discount rates at inception. Overall, application of discounting on the scale required by the proposed guidance is fraught with uncertainties, assumptions and insurmountable challenges.

Companies discounting reserves will be challenged to establish appropriate rates and develop systems to track discount rates, but a significant part of the problem is the price the industry will pay from a solvency perspective. Property/casualty insurers and regulators have always managed reserves on a nominal, undiscounted basis. Reserves are an important feature that protect the policyholders and assure that the money needed to pay claims is available. Insurers holding inadequate reserves often struggle to meet their claim
obligations when they are due. A.M. Best reports that inadequate reserving is the number one reason for insurer insolvencies.\(^3\)

NAMIC members care about this issue because insurance insolvencies are not just an issue for troubled companies. All insurers doing business in a state are required to participate in guaranty funds that pay the claims of insolvent insurance companies, so insolvencies affect all insurers whether they report on a GAAP basis or not. Trends toward a present value measurement will not produce more adequate reserves. Instead they may lead to less reserve discipline. Appropriate discount rate setting is not a precise science and minor errors in determining the appropriate rate can have disastrous results in this industry.

**Ideas to Make Proposal More Cost Effective**

Discounted reserves will not produce appropriate information for evaluating the strength of an insurer. Differences in arriving at an appropriate discount rate, differences in accuracy of information about the initiation of the contracts or portfolio and differences in the interpretation of the practical expedient for discounting claims will produce significant practice diversity. Ideas to reduce the cost of this proposal are as follows:

- Do not apply discounting to property/casualty reserves. This would have the most significant impact on cost.
- If discounting is required FASB can reduce cost and complexity by providing a practical expedient exempting claims settled within five years after the claim is filed from discounting requirements.
- For those property/casualty liabilities still subject to discounting set a much simpler composite rate as opposed to bottom-up or top-down approach. Clarifying the use of a AA corporate bond rate or a pre-determined risk-free rate that applies to all liabilities on a period basis will reduce the number of variables (rate and period) needed. This will reduce both cost and complexity in determining the discount rate.

**c. Lost Value of Decision-Useful Historical Accounting Data**

One of the most critical costs of changing the current GAAP standards for insurance financial reporting will be the loss of the alignment between U.S. GAAP, Insurance Statutory, and Tax reporting that currently provides very granular, rich information that users and preparers can access to assess performance or the quality of investments. The objective of preparers is to meet the informational needs of users so that they can best assess their risk and reward from transactions with the preparing entity. The ED restrains property/casualty insurers’ ability to communicate with users for the following reasons:

- The ED is inconsistent with the business model employed by property/casualty insurers.
- The ED would abolish valuation metrics that investors and other users have come to rely on by eliminating decades of company and industry data.

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\(^3\) AM Best, "Best’s Insolvency Study - Property Casualty U.S. Insurers 1969-2002" (2004). This study points to deficient loss reserves as the primary cause of 562 P&C insurer insolvencies during the study period.
Under the ED the adequacy of reserves and reserve development information is overly complex and is presented on a different measurement basis than current claims and claims reserving practices.

The interaction of discounting with an uncertain payout pattern will distort the true liability of the entity, rendering comparisons to other entities less meaningful than the current standard.

The aggregation by "portfolio" reduces information concerning company operations as many entities manage business and measure profitability on a different basis (account basis, profit center, etc.).

**Ideas to Make Proposal More Cost Effective**

The only way to avoid the loss of the historical data is to retain the current system and make targeted changes to address specific concerns. Otherwise this cost issue remains.

d. Cost to Small Insurers and Competition within the Insurance Industry

Many small companies have a single person responsible for accounting and do not have the financial or human resources to manage an operational, reporting and IT system change of this magnitude.

Wholesale changes in accounting require a significant investment in time and financial and human resources. Large insurers, which once only reported on a statutory basis report the cost to implement current GAAP reporting, in the hundreds of million dollars. This was to add a system that was not significantly dissimilar. The ED represents an entirely new approach to insurance accounting that will come at a significant cost to small insurers at a time when they are being required by state regulators to submit new enterprise risk reports, pay for new risk-focused examinations, comply with enhanced risk-based capital requirements and meet new corporate governance obligations.

The problems that created the financial crisis and drove the desire for convergence were the result of activities by large, systemically significant and interconnected banks and financial services entities. It seems the proposed solutions, including this insurance contracts accounting proposal, will only lead to further industry consolidation, and more "too big to fail" companies. Small companies unable to financially handle all of the new requirements and added costs will have limited options other than merger or dissolution. If FASB adopts this ED, we will very likely see consolidation in our industry not a strengthening of competition.

**Ideas to Make Proposal More Cost Effective**

The only way to avoid the impact on small companies is to retain the current system and make targeted changes to address specific concerns. Otherwise this cost issue remains. There is no effective way to override the impact to small insurers if NAIC decides to adopt the Insurance Contracts approach for statutory accounting. There is no mechanism to help small insurers with the impact they may feel through additional guaranty fund assessments when other companies go insolvent from inadequate reserving. There is no single adjustment to the ED that will make this very complex ED simpler so small companies do not have to invest significant costs to comply.
Questions for Auditors

Question 48: Describe the nature of the incremental costs of auditing the financial reporting requirements included in this proposed Update, distinguishing between one-time and ongoing costs. Explain which aspects of the model in this proposed Update are driving those costs.

The aspect which will drive costs in regard to short-duration contracts is the requirement to implement discounted cash flows. This aspect will also provide no benefit for users and produce more uncertain estimates of liability. One-time costs will include developing a whole new set of control procedures to address a complete reworking of the actuarial and accounting processes required to implement cash flow discounting, as none currently exist. There will be a demand for more informational technology, accounting and actuarial resources to perform the ongoing verification tasks prescribed in the control procedures. Further, there will be a need for more ongoing internal and external audit talent to monitor compliance due to the significant complexity of the proposed standard. However, this expense can be avoided if short-duration contracts were exempted from the proposed guidance and the excellent current GAAP standard for short-duration contracts, which is well understood by preparers, auditors and users, is retained.