October 25, 2013

Technical Director
File Reference No. 2013-290
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Subject: Exposure Draft for Insurance Contracts (Topic 834)

Introduction and Summary
The Progressive Corporation, through its insurance subsidiaries, is ranked fourth in market share in the U.S. private passenger auto market based on net premiums written. We have reviewed the exposure draft for Insurance Contracts (Topic 834)(“Update”). We appreciate the fact that the Board has expended a significant amount of time and effort to attempt to create a single comprehensive standard on accounting guidance for insurance contracts, as well as providing registrants an opportunity to comment on the proposal.

We would, however, like to express our views that the current accounting guidance provided in Accounting Standards Codification 944, Financial Services-Insurance, should be retained as it applies to the accounting and reporting by insurance entities for short-duration contracts. We believe that the current model provides the most meaningful representation of financial performance for short-duration contracts issued by insurance companies. Although a global standard for insurance contracts is a good objective, we do not believe the proposed standard is an improvement from current U.S. GAAP for short-duration contracts. In addition, the current accounting standard is widely used by insurance companies and is well understood by the users of the financial statements. Therefore, we recommend that the current U.S. GAAP standard should be the basis for any global insurance contract standard that may be adopted.

Through its efforts on developing a comprehensive standard on insurance contracts, we understand the Board’s objectives were to develop a standard that: i) provides decision-useful information; ii) improves comparability regardless of the type of entity originating the contract; and, iii) represents the economics of the transaction. We believe that the current exposure draft for insurance contracts, however, adds significant complexity, does not provide decision-useful information, reduces comparability, increases subjectivity, is inconsistent with the business model employed by property and casualty insurers, and would be overly costly to implement. In addition, the proposed standard is so complex that we believe that average investors (e.g., shareholders) would find it difficult to understand the financial performance of insurance companies and might lead investors to no longer have the confidence to invest in the insurance industry.
The following comments reflect our most significant concerns which are further addressed below in the “Questions for Respondents” section.

- **Measurement of Claim and Claim Expense Reserves**
  - We believe the FASB should continue to allow companies to select the model they believe is appropriate to produce the reserve level or range of reserves with which to apply actuarial judgment in establishing claim reserves. The choice of model, along with the ability to apply professional judgment, is in accordance with Actuarial Standard of Practice (ASOP) 43, “Property/Casualty Unpaid Claims Estimates,” promulgated by the Actuarial Standards Board, which suggests different methods or models be used depending on the type of product and/or coverage being reserved.
  - We believe the FASB should not require companies to establish claim reserves using a single statistical measure of an unbiased probability weighted estimate. ASOP 43 recognizes that one precise statistical measure is not optimal for all situations. In addition, our actuaries often use critical information (e.g., changing tenure of claims adjusters) that inherently is unable to be incorporated into any of the modeling methods when establishing our reserve levels.
  - By requiring the use of an unbiased probability weighted estimate, a company’s reserves could be inadequate potentially half of the time. Per AM Best, one of the leading causes for financial deterioration that leads to regulatory action is reserve deficiencies. We do not believe this is a desirable position for the insurance industry.
  - We do not believe that using a stochastic probabilistic methodology is appropriate in most situations because it is not well tested in the United States, is better suited to situations with high levels of uncertainty, which is not typical for property and casualty reserves, and requires additional actuarial expertise and more effort to produce results that may not necessarily be more meaningful.
  - Without further guidelines, testing, and validation, it is unclear how probabilistic reserving should be performed and whether it can produce results that better estimate the ultimate exposure.

- **Discounting**
  - We continue to believe that introducing discounting of claim reserves is inconsistent with the property and casualty business model where underwriting operations are separate from investing operations.
    - Stating reserves on a nominal basis is how reserves are managed internally, analyzed externally, and how they are ultimately settled.
    - By not disclosing nominal reserves in our basic financial statements, key operating metrics (e.g., combined ratio, loss ratio), which are widely accepted and used to measure underwriting performance, will not be comparable to current ratios.
  - Given our understanding that investors and analysts prefer to analyze information on a nominal basis, footnote disclosures may become more relevant than the financial statements themselves and analysts would likely request further information be provided in the footnotes.
  - The requirement to discount reserves and have changes in the discount rates recognized in other comprehensive income will introduce significant reporting complexity and will require insurers to modify their claim systems without any added benefits to users of the financial statements. The cost would most likely be significant since the information necessary to comply with the proposed requirement is not currently tracked.
  - We believe that discounting would provide very little benefit to the users of the financial statements. For Progressive, about two-thirds of our claim reserves are settled within 12 months and, therefore, would not be discounted under the proposed guidance. As to the remainder of our reserves, and in general for P&C claim reserves, the timing and amount of cash flows is uncertain such that discounting reserves would not provide more decision-useful information and would reduce comparability.
• **Onerous Contracts**
  o In determining the existence of onerous contracts, insurers should not be required to recognize the anticipated impact of low frequency, high severity events at the reporting date, regardless of their nature, that have not occurred or that are not both probable and reliably estimable. Existing premium deficiency and subsequent event evaluation, recognition, and reporting guidelines appropriately address low frequency, high severity events.

• **Portfolio Definition**
  o Additional clarification is necessary to accurately determine the definition of a “portfolio” under the proposed guidance. For example, some companies may define the portfolio of contracts at a product level, whereas others may define the portfolio at a more detailed level, such as product and geographic region. Without additional guidance, the determination of portfolios may be inconsistent and reduce comparability among entities.

• **Deferred Acquisition Costs**
  o Acquisition costs should continue to be disclosed as an asset. Classifying acquisition costs as a component of the liability for unexpired coverage decreases transparency and does not meet the existing accounting criteria for net presentation.

Below are our additional views relating to certain questions that were posed in the exposure draft.

**III. Initial and Subsequent Measurement**

*Question 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?

We do not believe that the proposed measurement model will produce relevant information to the users of the financial statements. As proposed, the model is inconsistent with the business model employed by all property and casualty insurers. In addition, we believe that the unique accounting proposed in the exposure draft will make it more difficult for investors and analysts to compare the financial performance of insurers to other financial services entities with whom we compete for capital investments. Lastly, the proposed measurement model will make it more difficult for analysts to assess the adequacy of claim and claim expense reserves ("claim reserves") due to the fact that the claim reserves that would be shown on the balance sheet would be presented on a measurement basis that is different than the measurement basis that would be used in our statutory financial statement (e.g., schedule P) as well as in the claim reserve development footnote disclosures.

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

We do not believe that the proposed measurement model will significantly improve the information that will be used in making economic decisions. The informational needs of users is enhanced when they are better able to understand the financial and operating performance of the company they are analyzing so that they can best assess the amount, timing, and variability of future returns. We believe that providing loss reserve development information would enhance our ability to communicate with investors and analysts, but only to the extent that the additional information was able to be presented on a consistent measurement basis in the footnotes and in the balance sheet and that it would be consistent with the statutory Schedule P information (i.e., presented on an undiscounted basis).
IV. Measurement Approaches

Question 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?

Yes, we agree that entities should apply different approaches to contracts with different characteristics. We believe that Life and Property & Casualty insurance contracts are fundamentally different. For example, life insurance accretes to a future benefit while P&C insurance measures an incurred liability; life focuses on net investment spread versus underwriting income for P&C insurers; and P&C insurers are unable to address underwriting/pricing issues through investing practices due to short duration of P&C contracts. As a result, we agree that Life and P&C insurance should have different accounting and reporting models that meet their unique characteristics.

For P&C insurance, we continue to believe that the accounting (i.e., measurement) and reporting model that is currently in place is the appropriate approach that should be used rather than requiring the use of the proposed premium allocation approach ("PAA"). The fundamental components of the existing model, such as the unearned premium reserve (UPR) and claim reserves are measured and reported in a manner that is very well understood by investors and analysts and contains 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. Lastly, changing the measurement model would render all of the historical information accumulated over time not meaningful.

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?

As discussed above, we continue to believe that the accounting and reporting model currently in place, rather than the PAA, is the appropriate approach for P&C insurance. Using the current approach has not resulted in any misclassifications of insurance contracts between short and long duration to the best of our knowledge under existing guidance.

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?

Our recommendation is that the existing guidance be retained as stated in ASC 944-60-25-3, “Insurance contracts shall be grouped consistent with the enterprise’s manner of acquiring, servicing, and measuring the profitability of insurance contracts...” We do not believe that anything is “broken” or otherwise dysfunctional with the current definitions. To the extent a new standard is adopted, additional clarification will be necessary to accurately determine the definition of a “portfolio” under the proposed guidance. Without additional guidance, the determination of portfolios may be inconsistent and reduce comparability among entities.
VI. Fulfillment Cash Flows

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?

We do not agree with the fulfillment cash flows, as set forth in the exposure draft, as a substitute for the principal reserving methodology currently in use in the U.S. for P&C claims, which is to project the ultimate settlement value using a variety of deterministic projection methods and then judgmentally weighting the methods based on the actuaries’ judgment about the relative strength of each method given the facts and circumstances at the measurement date to determine the actuarial central estimate. The substitution of the time-tested and validated variety of actuarially accepted projection methods with stochastic models that have not been validated for the purpose it is intended to be used is not supported by property-casualty preparers, analysts, or regulators.

A literal interpretation and application of the exposure draft would not permit the continuation of existing reserving practices and, based on discussion with the reserving actuaries, we do not believe that it would be an improvement to today’s practices.

The exposure draft requires the exclusive use of stochastic models to measure P&C claim reserves given the unbiased probability-weighted cash flows requirement. Stochastic models are not one of the top models that P&C reserving actuaries use to project ultimate P&C claim reserves due to the fact that these models require input assumptions that are typically derived from one of the other more transparent, time-tested, deterministic methods. In addition, stochastic models produce results that are not transparent and difficult to audit (e.g., will companies need to save each of the thousands of simulations for the auditors to review?) as well as the fact that they have yet to be adequately vetted and validated in the United States for the purpose of estimating claim reserves for GAAP and statutory reporting.

Despite the proposed mandated accounting requirement to use stochastic models to measure P&C claim reserves, reserving actuaries believe that they will continue to use deterministic methods because these methods continue to represent the best, most reliable tools that have been extensively tested and proven to produce reliable estimates. The results from the deterministic models would then be used to select stochastic model inputs and parameters to produce results that could be similar to the deterministic models in many situations, resulting in a highly inefficient use of time and money.

As drafted, reserving actuaries indicated that building block 1 equals a measurement that includes no implicit provision for uncertainty and, therefore, would produce deficient claim reserves on a more than infrequent basis, possibly 50% of the time, which is considered to be an unacceptable outcome. Currently reserving actuaries view the actuarial central estimate as a center point in the reasonable range of claim reserves calculated largely by the application of a variety of deterministic methods, which the actuary uses to gauge reserve adequacy. Under the proposed exposure draft, the requirement to use the mean of a statistical distribution would often represent a lower point in the range of an actuary’s assessment of reasonable reserves.

To the extent a new standard is adopted by the FASB, we strongly recommend that the final standard clearly allow a continuation of the application of the robust, time-tested deterministic actuarial methods and practices currently in use in the U.S. and elsewhere, and in accordance with ASOP 43, as these reserving methods produce the most reliable, comparable, and understandable measurements.
**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?

Consistent with current practice, we support the recognition of estimated changes in the anticipated gross settlement value of claim reserves in net income in each reporting period as the changes are identified. Separately, we do not support the introduction of discounting to claim reserves as we do not believe discounting enhances the ability of investors to assess the adequacy of reserves over time. See Question 15 for a discussion of the impacts of introducing discounting to the measurement of claim reserves.

**VII. Discount Rates and Discounting**

*Question 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?

In general, we do not support the discounting of P&C claim reserves. The inherent challenges of discounting claim reserves include the following:

- P&C claim reserves are non-interest bearing
- P&C claim reserves cannot be settled on a discounted basis
- No interest-bearing financial instruments exist with cash flows that match P&C claim reserves
- The cash flows associated with most P&C claim reserves are not fixed and determinable on an individual claim basis

As a result of the preceding, there are no obvious proxies or other market-based information to calibrate a discount rate for P&C claim reserves. Furthermore, calibration of a P&C claim reserve discount rate to asset returns does not appear prudent as it could encourage investment in riskier investments with higher yields and result in the ability to decrease reported reserves.

As a result, we believe that introducing discounting will result in increased complexity, increased subjectivity, and reduced comparability amongst insurers, which is inconsistent with the objective of GAAP reporting.

**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?

We do not believe that discounting of P&C claim reserves is appropriate. While discounting claim reserves may be supportable on purely theoretical grounds, we strongly believe that claim reserves reported on the balance sheet should not be discounted because discounting these reserves would impair the transparency and understandability of the basic financial statements.

Currently, claim reserves measured on a U.S. GAAP basis can be reconciled to Statutory-basis claim reserves and can be reconciled to the very granular claim data presented in the Statutory financial statements. The Statutory statements include Schedule P, which provides reserve development statistics for a 10-year period by company and by major line of business. Investors and analysts consider Schedule P a vitally important tool to assess an insurer’s ability to reliably estimate claim reserves. The current proposal would require different bases of measurement for claim reserves in the U.S. GAAP balance sheet (i.e., discounted) and for claim reserves presented in the Statutory claim development table disclosures (i.e., undiscounted). Analysts have indicated that claim development information would be much less useful if presented on a basis different from the measurement basis for claim reserves in the balance sheet.

In addition to transparency and understandability, we do not support the discounting of P&C claim reserves because it is not consistent with the P&C business model wherein claims are typically managed internally, analyzed externally, and ultimately settled all on a nominal (i.e., undiscounted) basis.
The P&C business model separates underwriting activities from investing activities. Under the proposed exposure draft, investment activities would be integrated into the underwriting model, which will require investors and analysts to back out the impacts of discounting to get back to reserves on a nominal basis. In addition, key operating metrics (e.g., combined ratio, loss ratio), which are widely accepted and used by investors to measure underwriting performance, would not be comparable to current metrics.

For claims that must be discounted under the PAA approach, insurers will be required to select and retain a yield curve that would serve as the reference point for all future discounting (as the claim ages) and interest rate changes and the difference between the historical rate and the current rate would be classified in other comprehensive income (OCI). It is unclear how often the difference in interest rates needs to be evaluated. If it is determined that the reevaluation needs to occur each reporting period, this can create a significant amount of information to be maintained, especially given the fact that we report results on a monthly basis rather than the required quarterly reporting.

As a result, both policy administration and reserving systems would need to be modified at a substantial cost. In addition, analysts have indicated that presenting claim development disclosures (i.e., Schedule P type disclosures) on a basis that is inconsistent with the measurement method applied in the balance sheet will not be helpful.

Therefore, we believe that introducing discounting will result in increased complexity, increased subjectivity, and reduced comparability amongst insurers, which is inconsistent with the objective of GAAP reporting.

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.

In general, we do not believe that discounting of P&C claim reserves is appropriate. In addition to the reasons discussed in Question 15 above (e.g., prohibits reconciliation to Statutory financial statements, decreases transparency and understandability, inconsistent with the P&C business model), having to record the effects of changes in discount rate in net income creates periodic income volatility, while the proposed solution to this is to classify the impact of all periodic interest rate change in OCI. This alternative, however, will require internal tracking of yield curves, which is currently not being done, creating yet another very complex process, along with costly system changes. If discounting were required, we believe that reporting such interest rate changes in OCI is preferred, although not all insurance companies are supportive of this alternative; this will result in increased complexity, increased subjectivity, and reduced comparability amongst insurers, which is inconsistent with the objective of GAAP reporting.

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?

Under the proposed guidance, it is our understanding that the changes in the insurance liability arising from the changes in the discount rate would naturally unwind as the incurred liability is extinguished through payment or changes in estimate. As a result, there would not need to be a test that would be required to trigger recognition in net income.
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?

In general, we do not believe that discounting of P&C claim reserves is appropriate, as further discussed in our response to Question 14.

If discounting is ultimately required, despite it not being consistent with the desires of analysts and not meeting the cost/benefit threshold, we propose that a practical expedient be introduced (e.g., the use of AA Corporates as the discount rate). Applying a practical expedient would:
- Decrease the complexity of the PAA proposal
- Enhance comparability

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?

In general, we do not believe that discounting of P&C claim reserves is appropriate, as further discussed in our response to Question 14.

If discounting is ultimately introduced, we would recommend that the discount rate be locked in at the “incurred date” rather than the proposed “contract inception date” since it would be difficult to apply a discount rate to a portfolio when contracts within the portfolio have different inception dates. In addition, requiring the use of contract inception date would require system changes that would be costly to implement.

IX. Acquisition Costs

Question for Preparers and Auditors

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?

We continue to believe that the existing accounting guidance should not be changed and do not believe that the proposed measurement model will produce relevant information to the users of our financial statements.

Under the proposed PAA, we do not believe that the liability for remaining coverage should be reduced for direct acquisition costs incurred due to the fact that this presentation reduces transparency and increases complexity to the extent that the two components that would be required to be netted on the balance sheet would however need to be tracked separately for presentation in the income statement and in the footnote disclosures. The requirement to net deferred acquisition costs with the liability for remaining coverage is also inconsistent with the existing accounting criteria relating to netting of balance sheet items.

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?

We believe that the recognition of acquisition costs as an expense in net income should be consistent with the recognition of earned premiums under the current accounting guidance, which is consistent with the pattern that the liability for remaining coverage under the PAA is reduced.
XV. Presentation

Question 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?

As previously discussed, we believe that the current business model, which separates underwriting from investing activities, should be maintained in the financial statements. Presenting reserves on a nominal basis provides the most decision-useful information for users and will continue to allow users to continue to obtain key operating metrics (e.g., combined ratio, loss ratio) from the financial statements that are consistent with historical information that has been accumulated over time and which are widely accepted measures of underwriting performance.

XVI. Disclosure

Question 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?

We believe that disclosures should support, not substitute, information presented on the face of the financial statements. As such, we recommend that claim reserves be presented consistently both on the face of the financial statements, as well as in the footnotes in a manner that is most meaningful to investors and analysts, which we believe would be on an undiscounted basis. Additionally, we would support targeted improvements to existing disclosures to the extent suggested by users of the financial statements to enhance their understanding of results.

XVII. Effective Date and Transition

Question 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?

Key drivers affecting the timing of implementation would include: time required to enhance systems; testing key controls, hiring and training additional resources within the actuarial, accounting, and information technology departments, assessing the impact on the business, and educating management, Board of Directors, and users of the financial statements. See question #47 for more details.
XVIII. Costs and Complexities

Question 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.

For issuers of short-duration contracts, the requirement to discount cash flows is the single item which will incur the most cost and provide the least benefit. Issuers of short-duration contracts currently do not have systems in place to perform discounting on the scale required by the proposed guidance, nor do many issuers have the expertise to determine appropriate yield curves for the various portfolios. More actuaries will have to be hired, or consultants engaged, because, for many entities, the reserving process itself will require a complete overhaul. 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. Processes will need to be changed to shift to a cash flow approach. The need for talent to perform such calculations will be not only an initial, but an ongoing and expensive cost consideration.

More accounting resources will also be required on an ongoing basis to apply the proposed guidance. More investment accounting resources will be required to track the many new variables introduced and explain to users the drivers of financial results obscured by the complex accounting procedures. More information technology resources will be required to set up and monitor the many new processes and track the many new variables required by the proposed guidance. The information technology system changes required in our financial reporting, loss reserving, and potentially the upstream claims handling systems will be significant in terms of both cost and duration.

The exact costs are very difficult to determine with accuracy, but it will likely be much greater than anyone is currently anticipating. We believe that the costs will be very significant.

Should you have any questions or wish to discuss any of our comments, please contact Brian C. Domeck (440-395-2001) or Jeffrey W. Basch (440-395-8913).

Sincerely,

Brian C. Domeck
Chief Financial Officer

Jeffrey W. Basch
Chief Accounting Officer

cc: Glenn M. Renwick, Chief Executive Officer
        Gary S. Traicoff, Chief Actuary