



LETTER OF COMMENT NO. 8



DAV

DEUTSCHE
AKTUARVEREINIGUNG e.V.

To

Financial Accounting Standards Board
of the Financial Accounting Foundation
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Via email: director@fasb.org,

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The Deutsche Aktuarvereinigung e.V. (DAV) appreciates the opportunity to provide comments on "An FASB Agenda Proposal: Accounting for Insurance Contracts by Insurers and Policyholders, Including the IASB Discussion Paper, Preliminary Views on Insurance Contracts".

GENERAL COMMENTS

Support for convergence of IFRS and US GAAP

Several large German insurance groups started 1997 and subsequently to report consolidated group financial reports under US-GAAP, continuing the application of those principles under IFRS 4 in IFRS-reports. One large German group was even listed at NYSE. Prior to that German insurance subsidiaries of US-based banking and insurance groups applied US-GAAP. Most of those entities are represented in the DAV working party "International Accounting" which prepared this response. In so far, we have now experience in applying US-GAAP to German business for more than 10 years.

In the EU it is prescribed that capital market oriented groups prepare their consolidated group financial reports under IFRS. We expect significant benefits from the permission to use those reports as well for listings in the US. We expect that this applies as well for financial reports prepared in future under IFRS 4 Phase II, not longer permitting to apply US-GAAP to insurance contracts but requiring approaches which deviate significantly from current US-GAAP approaches. However, there is a significant need to achieve comparability between US-based insurance groups, continuing to apply US-GAAP, and foreign insurance groups, applying IFRS. The complexity of insurance accounting would otherwise not allow users to compare the results. Hence, we recommend urgently a convergence of IFRS and US-GAAP regarding insurance accounting.

That refers especially to the need in a more and more global insurance world to consider a broad principle-based approach in accounting for insurance products which is applicable world-wide to any forms of products found all over the world. Currently, US-GAAP concentrates merely on products pre-dominant in US. However, in applying US-GAAP to the business of German insurance groups, some of them with significant foreign business, showed that many of the principles of US-GAAP, especially regarding participating life business, were reasonably applicable globally. In so far, well internationally tested principles of US-GAAP should be considered for being maintained as well within future IFRS 4 Phase II.

RESPONSES TO QUESTIONS

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

As outlined in the body of our response, we recommend a revision of US-GAAP for insurance contracts to achieve internationally applicable guidance, as well for foreign subsidiaries of international US-based insurance groups, and to converge together with IFRS.

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

The rules-based and product-specific approach should be changed to a principle-based approach to be applicable for foreign business. While e.g. in case of participating business (FAS 60.41 and 42 and SOP 95-1), separate accounts and for premium collapsing (premium and benefits repaying premiums not reported as revenue) in FAS 97 the attempt was (successfully) made to identify the economic characteristics requiring special treatment, in other cases US-traditional and US-specific approaches are prescribed. E.g. the technical effort to apply a separate amortization of deferred acquisition cost instead of applying a full prospective measurement as usual in other countries and intended under the IASB Discussion Paper Insurance Contracts causes significant technical effort in other countries.

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

Considering the complexity of insurance accounting, only a consistent basis of accounting principles can achieve comparability of financial reports. Considering the international orientation of insurance groups, as well principles are needed which are applicable to products world-wide. The diversity of insurance products world-wide require that the accounting standard is actually principle-based on highest quality level to cope adequately with such complex business which consists mostly simple on the acceptance of pure uncertainty for a price.

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

We believe them to be a suitable starting point, considering that a principle-based approach is proposed which is consistent with a modern technical view point. The approach has, although there are several concerns regarding relevant details, the potential to improve US-financial reporting for insurance contracts, since all available information can be taken into account without requirements to ignore artificially some information, e.g. as required under FAS 60 with a lock-in approach. We doubt whether the approaches result in a simplification, since they require, especially for non-life insurance, more sophisticated techniques than suitable considering the actually available information. Instead they should try to make the best from the available information. However, adequate application guidance might achieve the needed simplifications. The approaches will be as well suitable for US-business, since it is intentionally styled to be universally applicable achieved by a strict principle-based approach.

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

We fear that without suitable application guidance some of the requirements will result in calculations which are more detailed than reasonable, considering the quality of the available knowledge, i.e. accuracy which is not achievable at all is pretended by complex techniques. We believe it would be preferable not only to permit but to require straight-forward approaches like unearned premium liabilities, calibration to premiums or prior-year measurement in absence of superior knowledge. That would enhance comparability and avoid the need for proceeding complex and expensive calculations without any hope to gain any additional information.

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

We do not see any alternative from an international view point.

Question 3: Is there a need to address accounting by policyholders in an insurance contracts project? Why? If yes, should accounting by policyholders be addressed at the same time as the accounting by insurers? Can or should that wait until after the accounting by insurers is completed?

Taking insurance is a special form of a cession, i.e. a transaction transferring specifically the economic effects of events to one party, the cedant, to another party, the cessionary. Cessions have an unusual prominent role in insurance business, e.g. taking insurance, taking reinsurance, subrogation, commission claw-back, investment-linkage but especially some participation features found as well in few States in the US. Considering the unusual important role of cessions in insurance business, it would be helpful to develop overall principle-based accounting concepts for all forms of cessions. There is little sense to treat e.g. taking reinsurance conceptually different from taking direct insurance. The requirement e.g. to measure reinsurance taken at the cedant at current exit value could pre-determine the outcome of accounting for policyholders, which would not only be overly burdensome but as well be inadequate. The accounting for a cession at the cedant should be always consistent with cedant's accounting for the ceded item, otherwise there would be an accounting mismatch not reflecting properly the risk eliminating nature of a cession. If in case of reinsurance contracts the ceded item, the ceded direct insurance, is measured at current exit value that might not cause significant damage. But normally, ceded items, e.g. buildings insured, are not measured at current exit value. Considering that it is easily possible to make a reinsurance contract to a direct insurance contract simply by formal changes in its wording, differences between accounting for policyholders of direct insurance contracts and cedants of reinsurance contracts could cause significant possibilities for accounting arbitrage. Hence, we recommend considering the consequences.

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

Insurance contracts are extreme complex contracts, in addition considering their extreme variety all over the world, which might include a variety of features affected by any of the projects referred to. Insurance contracts cause most complex recognition, derecognition, measurement and presentation issues. However, we do not recommend awaiting the solution of all the issues mentioned, since those issues will need a permanent reconsideration and their development will never be finished. Insurance contracts are ideal items to develop approaches under extreme conditions. If concepts for assets, liabilities and performance are suitable in general for insurance contracts, it can be assumed that they work everywhere. We therefore recommend to develop insurance accounting closely with the developments in those projects but to look for reasonable and pragmatic solutions to achieve in even those extreme products suitable results and to use that knowledge gained here to fine-tune the general projects.