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November 16, 2007

1540-100

LETTER OF COMMENT NO. 12

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Email: director@fasb.org

Re: File Reference 1540-100 Invitation to Comment: An FASB Agenda Proposal: Accounting for Insurance Contracts by Insurers and Policyholders, Including the IASB Discussion Paper, *Preliminary Views on Insurance Contracts*

Dear Director:

Veris Consulting, LLC (Veris) appreciates the opportunity to provide comments regarding whether or not the FASB should add to its agenda a joint project on insurance contracts. Veris is a consulting firm providing highly specialized accounting, financial and research services in particular market niches, notably including the insurance industry. Veris' senior executives bring together a deep background in insurance having been "Big 4" insurance audit executives, senior financial executives for major insurance companies, and consultants to major U.S. and international insurance and reinsurance companies and having served on a number of regulatory and standard setting bodies, including the AICPA Accounting Standards Executive Committee, Insurance Company Committee and Committee on Relations with Actuaries. Veris also provides expert litigation consulting services to many prominent law firms involving a wide variety of insurance company accounting, financial reporting and auditing issues.

Please find below our comments in response to each of the four questions in the Invitation to Comment.

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

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Veris Response: While we would characterize the existing U.S. GAAP accounting for insurance contracts as reasonably comprehensive and effective in providing credible, comparable and understandable financial information, we believe it is critical that the FASB add the joint project on insurance contracts to its agenda to maximize its influence on the development of global standards.

As evidenced by the list of pronouncements in Appendix A of the Invitation to Comment, U.S. GAAP currently includes a large number of standards applicable to accounting for insurance contracts. In particular, FASB Statements No. 60, 97, 113 and 120 form the foundation and reflect a consistent effort over the years to establish meaningful standards responsive to developments in the industry.

At Veris, we often serve as expert witnesses in litigation related to insolvent insurers, on behalf of both plaintiff and defendant parties. In our experience, life insurance failures generally involve problems related to invested assets. Failures of property/casualty and health insurance companies almost always involve claim reserve inadequacies. In these circumstances, the problems typically have not been related to any inadequacy in the related GAAP standards.

However, substantial litigation and disputes have arisen related to certain areas of the U.S. GAAP insurance model, most notably reinsurance and discounting of property and casualty loss reserves. In the wake of the recent wave of restatements and litigation involving finite risk reinsurance, we understand the FASB has moved forward to supplement existing guidance and plans to issue an Exposure Draft yet this year on risk transfer and insurance/reinsurance disclosures. With regard to reflecting the time value of money in property and casualty loss reserves, the issue has been actively debated for many years, but opinions and current practice continue to vary. (It appears, however, that this issue is being addressed head-on as part of the IASB's insurance project.)

In addition, we have seen financial reporting problems related to a lack of specific statutory accounting guidance, but to date most of the litigation has involved periods prior to the Codification of Statutory Accounting Principles becoming effective in 2001.

Therefore, viewing U.S. GAAP in isolation, we do not see an urgent need for the FASB to comprehensively address insurance accounting. However, over the past five years since the Norwalk Agreement, both the FASB and the IASB have remained committed to the development of consistent reporting standards worldwide to support global capital markets (aka "convergence"). More recently, both organizations have apparently agreed that removing all differences between U.S. GAAP and IFRS would take too long, but that the priority should be to align the major substance as expeditiously as possible.

Now the IASB is moving forward on a project to develop a comprehensive standard of accounting for insurance contracts with an Exposure Draft expected in 2009 and final standard in 2010. In its Discussion Paper, *Preliminary Views on Insurance Contracts,* issued in May of this year, the IASB has described an insurance accounting model that differs meaningfully in many fundamental respects from existing U.S. GAAP. The scope of significant differences is highlighted in the tables in the FASB's Invitation to Comment, but at the heart of the IASB's preliminary model is the switch from cost-based approaches to valuing insurance liabilities to a fair value approach based on current exit value.

This fundamental change, while theoretically consistent with the concepts in FASB Statements No. 157 and 159, would essentially discard many of the key principles of U.S. GAAP insurance accounting and financial reporting developed over the years by the FASB and the AICPA. The ramifications of this change are many, including:

1. Applying a single set of recognition and measurement requirements to a wide variety of insurance contracts,
2. Expensing of acquisition costs,
3. Discounting of all insurance liabilities at current market rates,
4. Constant resetting of assumptions,
5. Incorporation of a market-based risk premium in the measurement of liabilities,
6. Possibility of gain recognition at contract inception, and
7. Fundamental change in emphasis from the emergence of earnings over the life of the underlying contracts to the financial condition at each balance sheet date.

The greatest appeal for the proposed IASB standard lies in its comprehensiveness and its potential to standardize reporting across product lines as well as across national boundaries. Accordingly, given that both the FASB and the IASB are committed to convergence and that the IASB is moving forward to potentially dramatically redesign insurance accounting, we believe it is critical that the FASB add the joint insurance accounting project with the IASB to its agenda. Otherwise, the opportunity will be missed to maximize the influence of the FASB and the U.S. insurance industry in the design of global standards for recognition, measurement, presentation, and disclosure of insurance contracts.

<u>*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?</u>

<u>*Veris Response:*</u> We believe that certain of the IASB's preliminary views may conflict with some of the precepts that guide the FASB in its activities. Specifically, we note that the FASB's stated mission emphasizes improving financial reporting by focusing on relevance, reliability, comparability and consistency. Also, from a practical standpoint, the FASB strives to promulgate standards where the expected benefits exceed the perceived costs and to do so in ways that minimize disruption to the continuity of reporting practice. As discussed below, we are concerned that the use of exit values to measure insurance contract liabilities may actually reduce reliability, comparability and consistency, while significantly increasing cost. We further question the relevance (and, thereby, the benefits) of the information provided by this proposed approach for many financial statement users.

Our largest single concern relates to the increased subjectivity associated with valuing insurance contract liabilities at current exit value. The proposed exit value approach involves estimating not only multiple probability-weighted streams of future cash flows, but also the appropriate current discount rates and, perhaps most difficultly, the margin market participants would require for bearing risk and/or providing other services.

Insurance company financial results are already difficult for users to understand and compare, and the accounting is already more complex than for most other industries. One of the primary reasons, of course, is that insurance financial reporting is inherently based largely on estimates of future events. In our litigation work, we consistently see the problems created by this uncertainty and the wide range of estimates that can be produced by qualified specialists from a single set of facts and circumstances. It seems to us that the IASB proposal is adding significant additional estimation variables, which will compound the difficulties already inherent in deriving reasonable and comparable insurance contract liability valuations.

This additional subjectivity will have a significant negative impact on the ability of financial statement users to understand and assess financial condition and to make meaningful comparisons across companies. Further, it will inject significant additional cost and complexity into the valuation process.

The benefit of a more faithful representation at the balance sheet date should also be questioned. Traditionally, insurance regulators have had the greatest interest in current financial condition. Since their primary focus is on solvency, they have developed their own separate (statutory) accounting model, which will be unaffected by the current debate. Creditors and other third parties have an interest in current financial condition as well, but their focus is more on current liquidity and ability to pay, which will not be illuminated by valuing insurance contract liabilities at current exit value. In fact, the IASB has acknowledged that in the insurance context, exit value is primarily a theoretical concept that departs from real world circumstances. In the majority of circumstances, insurance companies will not, should not, and cannot transfer their liabilities to third parties.

The predominate users of GAAP financial statements are, arguably, investors. Typically, investors are more concerned with the ability to project future earnings than with the current valuation of existing assets and liabilities. In many respects, the U.S. GAAP insurance accounting model with its emphasis on matching revenues and expenses is better suited to measure earnings emergence and, thereby, facilitate projections of future earnings. The IASB proposal would cloud the earnings pattern with the impact of short-term volatility in estimated cash flows, discount rates and risk/service margins.

We are not in a position today to make definitive conclusions regarding whether the IASB preliminary views should be accepted or rejected. However, the magnitude of the proposed changes and the significance of the potential concerns discussed above, drive us to the conclusion that it is imperative that the FASB be as involved as possible in the dialogue and the process. The insurance industry needs and deserves a very rigorous debate on these issues before sweeping changes are made that effectively discard the accounting model developed over many years of effort in the U.S. We recognize, of course, that the FASB will not be required to accept or adopt the provisions in the eventual IASB standard, but all parties will be best served by minimizing any differences in accounting across the globe.

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?

Veris Response: Since the existing guidance on accounting by policyholders is limited, this should be addressed at some point. However, we believe that the current focus should be limited to accounting by insurers. Once the insurer accounting model is established, it will be more evident how and with what urgency accounting by policyholders should be addressed. Having said that, we believe the FASB should participate with the IASB when it addresses policyholder accounting. Our understanding is that the IASB currently considers policyholder accounting to be a lower priority to be addressed at some point in the future.

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?

Veris Response: Given the relative effectiveness of existing U.S. GAAP for insurance contracts and the number of other substantive issues currently facing the FASB, it might seem logical to make further progress on other projects with broader application (including conceptual framework, revenue recognition, liabilities and equity, financial instruments, and financial statement presentation) before tackling a possible sweeping revision to accounting for insurance contracts. The output from these other projects would undoubtedly provide additional insight that would influence the insurance contracts project. Also, further refinement of the FASB's move toward fair value accounting as expressed in numerous pronouncements (including most recently Statements 157 and 159) would be helpful in determining the appropriate application of fair value to insurance company accounting and financial reporting.

While delaying a project to reevaluate insurance accounting until further progress has been made on the other projects noted above would seem logical in the context of U.S. GAAP alone, the world is, of course, much broader. Certainly, the insurance industry is global and becoming more so every day, as companies based outside the U.S. expand their U.S. operations and domestic companies seek expansion into foreign markets, often in search of more attractive opportunities for growth.

Therefore, we reiterate our strong recommendation that the FASB join with the IASB as soon as possible in its comprehensive consideration of insurance accounting and financial reporting.

Additional Comments:

We strongly encourage the FASB to heavily involve representatives of the investor community in this project to ensure that the final standard meets the needs of this huge constituency in a cost-beneficial manner. Strong participation by the recently established Investors Technical Advisory Committee might be one way to facilitate this.

Further, we believe that any significant departures from existing U.S. GAAP be subject to field testing prior to finalization. Certainly the IASB's preliminary views include changes that could have significant related costs and other consequences that would be difficult to accurately assess in the absence of field testing.

Finally, Veris would be pleased to participate in the Insurance Forum in early 2008 where these issues will be discussed further and to provide a representative to join any task force or other working group to assist in moving this project forward.

Sincerely,

Kent E. Barrett

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