

December 14, 2010

Sir David Tweedie, Chair International Accounting Standards Board 30 Cannon Street London EC4M 6XH, United Kingdom Ms. Leslie F. Seidman, Acting Chair Financial Accounting Standards Board 401 Merrit 7 Norwalk, CT 06856-5116

Re: Insurance Contracts Exposure Draft and Discussion Paper

Dear Sir David Tweedie and Ms. Leslie Seidman:

Nationwide Insurance appreciates the opportunity to comment on the IASB *Insurance Contracts* Exposure Draft (ED) and the FASB Discussion Paper: *Preliminary View on Insurance Contracts* (DP) (collectively proposed guidance). The Nationwide Insurance Enterprise (Nationwide) is comprised of three affiliated mutual insurance companies and their subsidiaries under common management, operating both property and casualty and life insurance companies. Nationwide is one of the largest diversified insurance and financial services organizations in the world with 2009 annual revenues of \$21 billion and assets totaling \$140 billion.

While we are supportive of the overall objective and purpose of the joint project between the FASB and IASB (collectively the Boards) to achieve convergence for insurance contracts, we do not believe these goals will be achieved through adoption of the guidance as proposed. Furthermore, we strongly believe the complexity of modifications as proposed requires significantly more analysis in order to minimize unintended, detrimental impacts to the reliability of information utilized by investors. Given the importance of this guidance, we respectfully request the Boards modify their project plans and timelines to ensure convergence through thoughtful re-deliberations and reconciliation of differing views. Furthermore, it is imperative that more robust field testing is performed, taking into consideration an expansive range of scenarios and assumptions to better understand how the proposed model will respond. While expediting a standard is important, achieving a high-quality standard which is beneficial for both investors and industry participants is critical.

We also respectfully request that the Boards more heavily weigh the economic impact to preparers and users of financial statements from issuing non-convergent guidance. Accounting changes to insurance contracts are complex and require significant operational and information technology changes. We realize that implementation and training costs for accounting guidance changes are a necessary cost of business. Many companies, including Nationwide, believe that these costs can be significantly reduced if joint guidance issued by the Boards is aligned. We are very concerned with the possibility that we may be required to implement changes multiple times over a relatively short period of time as would result if we were required to comply with US GAAP modifications and then subsequently convert to a different IFRS standard. This scenario would be very costly for insurance companies with a downstream detrimental impact to investors and policyholders.



While striving for convergence, the Boards should coalesce around a model which better reflects the economics of the insurance business. For many products, unlocking the discount rate creates volatility in earnings not reflective of management's expectation of profit and loss emergence. Also, requiring the use of a mandated discount rate which is not indicative of pricing methodologies could result in day-one accounting losses on economically profitable products. If these requirements as well as others identified in our comment letter are retained in the final standard, insurers may change behavior to manage financial statement accounting volatility resulting in additional costs to be borne by policyholders. For example, management may choose to purchase new hedging instruments simply to dampen accounting volatility created by the proposed standard. Alternatively, management may reduce the availability or change the pricing of products, such as spread-based life and annuity products, to achieve a more accurate pattern of accounting earnings that does not reflect day-one accounting losses. We prefer an accounting model that is more reflective of our business economics so that downstream pricing and product availability impacts are minimized.

While proceeding with these joint deliberations, Nationwide respectfully requests consideration of the following main recommendations for the insurance contracts joint project.

Measurement

- The method to calculate the discount rate and the requirement to unlock the rate each reporting period should reflect the company's business strategy, such as asset-liability management strategy and pricing techniques.
- The composite margin approach is preferable to the dual margin approach. The margins should be realized into income based on the release of exposure.
- A principles-based approach which focuses on the purpose of the insurance contracts should be used to determine which contracts should be accounted for under the modified measurement approach instead of the proposed time-based bright-line.
- The unbundling principles and examples should be clarified to avoid industry divergence. Unbundling should only be required for embedded derivatives bifurcated under today's accounting guidance and goods and services combined in a contract for reasons with no commercial substance.

Transition

- Upon transition, short duration contracts should not be required to use the fulfillment method. Rather, retrospective application of the modified measurement approach is preferred.
- Rather than inflating equity with profits that are prematurely recognized at the determent to future profits, a transition adjustment should be deferred to the balance sheet and amortized similarly to the methods used for the release of the residual/composite margins.

Presentation

Pertinent information such as premiums and claims and benefits expense should be displayed
prominently on the face of the statement of comprehensive income. The summarized margin
presentation approach as proposed does not provide an adequate representation of an insurance
company's comprehensive income.

We expound on our key recommendations in the following pages.



COMPREHENSIVE RECOMMENDATIONS:

Measurement

Discount Rate

Method to Calculate the Discount Rate

Currently the guidance requires the use of the risk free rate plus an adjustment for illiquidity. Instead, we suggest that the guidance should incorporate a principle that the discount rate should be consistent with the insurer's business strategy including pricing and approach for matching assets and liabilities.

We believe that the definition of an illiquidity premium as proposed is unclear so inconsistency in application will likely result. Additionally, the proposed method does not reflect the economics of all insurance products. A significant portion of insurance business consists of long-term, illiquid liabilities that are priced and managed in concert with the assets backing them in order to provide for the ultimate cash flows along with a provision for profit. The requirement that such business be valued using a risk-free discount rate could lead to accounting losses at issue that are not representative of the economics of this business strategy that is reasonably expected to be profitable in the long run. For example, our fixed life insurance products are priced with the presumption that investment income is a significant component of the profit margin for the product. To discount at a rate that does not reflect the yield on the assets backing these liabilities could result in contracts with losses at inception in the accounting model, when in reality, management reasonably expects these products to be profitable.

Unlocking of Discount Rate

We also propose the guidance should not prescribe the requirement to use the discount rate as of the reporting period (unlocking the discount rate), nor should it prescribe the requirement to use the discount rate in existence at inception of a product (locking the discount rate). Rather, the requirement to lock or unlock the discount rate should be based on management's business model, including asset-liability strategies and the nature of the underlying liabilities. This decision should be made at a level consistent with how management applies the strategies.

A significant portion of insurance business consists of long-term, illiquid contracts for which the ultimate fulfillment value does not depend on changes in interest rates. The requirement that such business be valued each period using a current market discount rate will lead to significant short-term fluctuations in value that are not representative of the economics of this relatively stable, long-term business. For example, insurance liabilities, such as a life-contingent immediate annuity or a term life insurance contract, could have volatility in results that is not indicative of the true economics of the product as the ultimate settlement amount is not dependent on the changing interest rate environment. Our concern is that a change in the accounting guidance to require the unlocking of the discount rate would cause insurers to at times appear in distress (or, conversely, flush with excess capital), when in reality, the pricing is adequate as proven through historical experience.



The IASB financial instruments standard allows for assets held for the collection of cash flows as part of a business strategy to be recognized at amortized cost. We assert that this same reasoning should be applied to insurance liabilities as well using a similar business strategy test. It is unclear why the ability to lock in the discount rate is not provided since many insurance liabilities are managed in this manner and the liabilities are less liquid than the assets held to back these liabilities. A lack of symmetry between the assets and the liabilities would distort the financial statements and misrepresent the economic relationship of the policyholder commitments and the assets used to back those commitments. Furthermore, the procyclical effects of a mark-to-market balance sheet that caused many to support an amortized cost model for the financial assets should result in the same concerns for the liability-side of the balance sheet. Accordingly, the ability to lock the discount rate at inception should be provided for liabilities held in the appropriate business strategy. Not allowing insurers who prepare U.S. GAAP or IFRS financial statements the same treatment as financial liabilities, which exhibit similar risks, could result in a competitive disadvantage.

Margins

Composite Margin or Dual Margin

We support the FASB composite margin approach. While we understand the theory behind a risk adjustment, we have concerns that the costs of a dual margin approach outweigh these benefits. We are concerned that the techniques used to estimate a risk adjustment are far too subjective and could result in inconsistency between insurers' financial results. The composite margin would eliminate the need to use subjective methods that decrease comparability as it is calibrated to inflows and outflows at inception of a contract.

Release of Margins

The Boards have proposed two different methods for the run-off of the margins (residual or composite respectively). We do not support the IASB method that places a heavy emphasis on the pattern of benefits and claims, which would result in a heavy bias towards later profit emergence. The FASB method appears to allow for the release of the margins partly in proportion to expected claims and benefits and partly in proportion to exposure (as used to allocate premiums), which results in more appropriate recognition of profits given the component related to exposure. While the FASB formula is preferable to the IASB proposal, we would suggest the Boards consider a method that releases the margin entirely based on exposure. We suggest the use of projected in-force, such as the annuity account balance or a life insurance death benefit, to drive the release of the margin. Additionally, we would support allowing changes in assumptions within the cash-flows that result in volatility to first be applied to the remaining margin that has yet to be released prior to the change in assumptions affecting the income statement. This buffering method would better portray the results of the business by removing short-term volatility that is not reflective of the economics of the business.

Modified Measurement Approach for Short Duration Contracts

Criteria for Qualifying for the Modified Measurement Approach

We support the use of a two-model approach for insurance contract accounting. The business models for property and casualty insurance and life insurance are fundamentally different and as such warrant



different accounting. While we agree with the proposal to provide an alternative approach for the measurement of short-duration contracts, we do not agree with the time-based bright-line that is provided in regards to coverage periods of approximately one year or less for determining which contracts are required to apply the modified approach. We think this bright-line is arbitrary and incompatible with insurance coverage and pricing options, particularly in the property and casualty business.

We propose that the criteria for determining which contracts apply the modified measurement approach should focus on the purpose of the insurance contract. Examples of contracts that would fall into the modified measurement approach include those that protect policyholders from losses arising from damage to or destruction of insured property by a defined event, theft of property, dishonesty of employees, failure of others to pay debt or perform contractual obligations, loss of earning power, and liability to third parties. This would include most insurance contracts currently within the scope of property-casualty accounting guidance. Therefore, in instances where it is common practice to issue contracts that have multiple-year coverage periods, such as in certain commercial lines, the accounting and presentation for those policies would not be split under two models even though the economic substance is essentially the same. All contracts containing insurance risk that do not meet these criteria would then use the fulfillment method. If the Boards decide to retain the current bright-line with regards to coverage period, then it is our belief that this will result in a new model that is less useful than existing accounting standards, resulting in less relevant and understandable information for our financial statement users.

Pre-claims Liability

We agree with the Boards' proposal to reflect a pre-claims liability that would essentially be the equivalent of the premiums received that are within the boundary of a contract less incremental acquisition costs. We recognize this is consistent with the customer consideration approach taken in the proposed guidance for Revenue Recognition. However, we do not agree with the proposal to discount the pre-claims liability. The minimal benefit that may be gained by discounting the pre-claims liability, only to accrete the liability over a very short period of time, would not support the added costs of doing so. An exception to not discount the pre-claim liability for an insurance contract would be theoretically consistent with the exception proposed within the Boards' Exposure Drafts for the Leases joint project, which provides this practical expedient for all for leases covering periods less than one year.

Onerous Contracts Test

We agree with the underlying principles supporting the use of an onerous contracts test. Overall, the benefits of this requirement are that it is conservative and would discourage companies from using an overly-aggressive and risky growth strategy to boost short-term profits. However, we disagree with certain aspects of how the test is performed under the proposed model that we believe are unnecessarily cumbersome or that may distort the underlying economics associated with short-duration contracts. We believe that the level of aggregation required for the testing is at a far too granular level. Any benefit that is believed to be gained from performing the onerous contract test at such a disaggregated level would not exceed any reasonable cost-benefit threshold. Additionally, requiring the use of present value techniques for performing this test for short duration business adds unnecessary additional complexities for little to no benefit. Alternatively, we propose the Boards consider modifying the onerous contracts test so that it is performed in a similar manner as the premium deficiency testing that is performed under existing U.S.



GAAP requirements. We believe that in doing so the test would still achieve its desired aim while not being overly complex.

Unbundling

Through discussions with industry peers, we have encountered widely differing interpretations of the unbundling principle and related examples provided in the proposed guidance, in particular for account balances. If retained in the final standard, this confusion could result in divergence of industry practice resulting in a lack of comparability. To alleviate this confusion, we support a clearer principle and examples within the guidance. This modified principle should only require unbundling when it does not result in arbitrary allocations between the insurance and non-insurance components. We believe embedded derivatives that require bifurcation under current guidance (e.g., equity indexed annuities and living benefits such as guaranteed minimum account balances) and goods and services combined with a contract for reasons that have no commercial substance are the only items that would not result in arbitrary allocations between insurance and non-insurance components and should be the only components required to be unbundled.

Additionally, it is not clear how unbundling and the unit-linked contract presentation interact. Some interpret the guidance to require first unbundling of the unit-linked balance and then under the financial instruments guidance a special presentation for unit-linked contracts should be followed. Others view unbundling to not be a prerequisite for the special presentation which could result from both the insurance contracts standard and the financial instrument standard. We respectfully request that you clarify the interaction of these two paragraphs. We support the view that a unit-linked contract should qualify for the special presentation regardless of whether or not it is unbundled.

Transition

Short Duration Contracts

Within the IASB exposure draft, the transition provisions result in the measurement of each portfolio of insurance contracts at the present value of the fulfillment cash flows. This does not allow for the modified measurement approach to be used for short duration contracts. As noted above, we support a separate modified measurement approach be applied to short duration contracts. We support this approach be applied at transition and to future business. We feel the modified measurement approach, given its similarity to the existing unearned premium approach used by many countries, would naturally flow between old and new guidance and could easily be applied on a full retrospective basis and would result in more relevant accounting results.

Long Duration Contracts

The transition methods outlined in the IASB's exposure draft would result in the difference between existing insurance balances and new balances measured under the fulfillment method that have to be reflected as a cumulative effect adjustment to retained earnings for the earliest period presented. This method will result in an inflated equity position where profits will be prematurely recognized while limiting future profits associated with existing blocks of business. We strongly feel this method will grossly distort the financial results of the life insurance industry for many years. This is especially true



for companies with large in-force blocks of business as this will reduce profitability and skew return on equity metrics that could result in a higher cost of capital, lower stock prices, and other unintended consequences for these companies relative to other financial services companies.

Additionally, we are concerned that the proposed guidance results in the risk adjustment functioning as the primary source of future profits upon transition. Upon transition, as insurers will not have the ability to compare assumptions used in the development of the risk margin with other insurers, the lack of comparability could affect both the effect of adoption within equity and future emergence of profits as differing risk adjustments are later released.

We would advocate any transition adjustment should be deferred to the balance sheet and amortized similarly to the methods used for the release of the residual/composite margins. We understand the Board's reservation that this will calibrate future profits to existing accounting principles; however, we feel the resulting lack of comparability between growing companies and those with mature in-force business is more concerning. We note that under our proposed approach, analysts could see the separate effect of the transition margin on earnings and make adjustments accordingly. As proposed, it would be more difficult for the analysts to make adjustments to show the effect on profits, as the duration and magnitude of the effect is not as transparent.

If the Boards continue to believe this alternative proposal to be undesirable, we then respectfully request the guidance provide the option to use full retrospective application. Further, we would request that retrospective application allow for use of practical expedients at transition to enable future profits associated with in-force business to be recognized.

Presentation

We do not believe the proposed summarized margin presentation approach will provide adequate information to the users of insurance companies' financial statements as it falls short in conveying all the key drivers within an insurance business. While we agree presentation of comprehensive income should reflect the movements in the building blocks used in the measurement of an insurance contract, we believe it is equally important to reflect information about the premiums and claims and benefits amounts prominently on the face of this statement. This information is important for users to understand the growth of the insurance enterprise along with the risks accepted as part of this growth. Accordingly, we do not believe such pertinent information should be presented only in the financial statement footnotes.

Additionally, the insurance contracts guidance will result in a fundamental change in how insurance financial statements should be understood. Education efforts will be enormous to help management, boards of insurance enterprises, analysts, ratings agencies, and other key financial statement users to understand this new basis of accounting. We believe that the recognition of premiums as deposit receipts and claims, benefit payments and expenses as repayment of deposits would be a fundamental change to current practice which will result in a loss of essential information for users of financial statements and will further complicate the education of these users of financial statements. A blend of the written premium approach and earned premium approach found in the FASB DP would represent a compromise between the old and new methods of financial statements that will ease the transition and education of these users. We propose that the contracts qualifying for the modified measurement approach should



display earned premiums, which would be a natural component of the amortization of the pre-claim obligation. The contracts measured under the fulfillment cash flows should be presented using the written premium approach. Additionally, for the reasons outlined above, this approach has the added benefit of presenting key performance metrics such as premiums, claims, benefit payments, and expenses on the face of the financial statements.

We further recommend that non-incremental acquisition costs not be disclosed as a separate line item on the face of the Statement of Comprehensive Income or within the footnotes. We note that the FASB recently issued Accounting Standards Update (ASU) No. 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. While the focus of this ASU was to address diversity in practice regarding the interpretation of which acquisition costs were able to be deferred, we believe that diversity in practice extended also to what costs in general were interpreted as falling under the categorization of acquisition costs. The definition within the IASB ED would not help to clarify this issue; however, we do not suggest that a clearer definition be crafted. Rather, we propose that the requirement to separately report or disclose this information be removed from the guidance, as this information is not as meaningful to a financial statement user. In addition to being prone to inconsistency between entities, we think that the additional operational effort of breaking out these expenses outweighs the benefit to financial statement users of seeing them reported separately.

CONCLUSION:

We are supportive of the overall objective and purpose of global convergence of accounting standards, however, we believe significant modifications to the proposed guidance are necessary. We believe the recommendations discussed above will assist in the achievement of the Boards' objective of developing a high-quality standard that addresses the recognition, measurement, and presentation of insurance contracts.

Additionally, we have attached as an appendix to this letter Nationwide's response to the comprehensive listing of questions asked by the respective Boards. For ease of administration for the Boards, the letter submitted to the IASB includes the responses to their questions and the letter submitted to the FASB includes the responses to their questions.

We hope these comments assist you during your re-deliberations of the proposed guidance. In the event that any Board or staff member would like further clarification of our positions, we would be happy to explain them in greater detail.

Respectfully

James D. Benson

Senior Vice President, Enterprise Controller and Chief Accounting Officer

Nationwide Insurance

Appendix – Response to FASB Specific Questions

1. Are the proposed definitions of insurance contract and insurance risk (including the related guidance) understandable and operational?

Yes, we think the definition of insurance contract and insurance risk in the Discussion Paper accurately reflects the intended purpose and mechanics of an insurance arrangement and would be commonly understood and operational. As such, we consider these definitions a sound basis on which insurance accounting guidance can evolve and operate going forward.

We would also like to take this opportunity to express our disagreement with the proposed contract boundary principle. The guidance requires an insurer to recognize an insurance contract liability or asset at the earlier of the bind date and when the insurer is first exposed to risk under the contract. We believe this requirement may have unintended legal consequences for entities that underwrite property-casualty contracts. In most jurisdictions within the United States, property and casualty insurers are not liable for any losses that occur between the bind date of the contract and the effective date of coverage. Given that property and casualty insurers are generally not "legally" exposed to risk until the effective date of coverage, it seems inappropriate to account for an obligation before the legal obligation is incurred. If the accounting for an insurance contract begins prior to the legal obligation to provide coverage, this could have the effect of changing the current legal environment to one in which the insurer is now considered to be liable as of the bind date since accounting for the liability has already occurred. Additionally, this requirement would be a costly change from current practice for both life and property and casualty insurance companies. In order to comply with the proposed definition, companies would have to update underwriting and actuarial software to begin tracking policy bind dates, which are not readily available today. Considering the multiple distribution channels we sell through, this change would involve implementing complex new underwriting and reserving processes that would not provide any additional benefit to our financial statement users.

Furthermore, we also have concerns with how the proposed boundary principle interacts with certain reinsurance agreements. For example, in regards to reinsurance arrangements whereby the reinsurer agrees to reinsure contracts that commence during the coverage period (i.e., on a risk-attaching basis) the reinsurer would be required to recognize a liability for contracts that have not been underwritten at the inception of binding the reinsurance agreement.

In light of these concerns, we would propose that the contract boundary principle be revised so that recognition begins when the insurer is first exposed to risk.

2. If the scope of the proposed guidance on insurance contracts is based on the definition of an insurance contract rather than on the type of entity issuing the contract, would financial reporting be improved?

Yes, we think the Discussion Paper's definition of an insurance contract will improve financial reporting as it is a more authentic representation of the substance of an insurance contract, which is not always correlated with the type of entity that issues the contract. As such, we think this definition will result in greater transparency for financial statement users as to the existence of insurance arrangements across multiple industries.

3. Do you agree with the proposed scope exclusions? Why or why not?

No, we believe that financial guarantees should not be within the scope of the guidance. If financial guarantees represent derivatives, such as many credit default swaps, they should be subject to the financial instruments guidance. If they do not represent derivatives, other existing guidance, such as the guidance on contingencies, has sufficiently resulted in proper accounting for these risks.

We are especially concerned about guarantees issued between parents and subsidiaries, between entities under common control, or by a parent on behalf of a subsidiary and feel these should also be excluded from the scope of this guidance. We believe that without such a scope exception reporting entities could be subject to unintended consequences.

For guarantees issued between parents and their subsidiaries, we are concerned that any guidance which requires recognition of the guarantee liability within the consolidated financial statements could end up resulting in duplicate recognition of the same underlying obligation in the consolidated financials. To help illustrate this assertion, assume Company A has provided a guarantee to its subsidiary, Company B, that would pay a debt obligation of Company B if Company B were to suffer a loss which would render them unable to pay their obligation. Company B will recognize their debt obligation and Company A will recognize a liability for the financial guarantee provided. Upon consolidation however there would be no offsetting "guarantee asset" on Company B's Statement of Financial Position allowed against which the guarantee liability could be eliminated. Any "guarantee asset" would be considered a gain contingency and would be specifically prohibited under most existing authoritative accounting literature. We do not think this duplication would be a faithful representation of the amount owed to the third party. Additionally, a

parent's guarantee of its subsidiary's debt to a third party is essentially a guarantee of the consolidated entity's own performance and therefore it seems counterintuitive to recognize a liability to reflect the guarantee obligation.

As such, we recommend that the scope exclusion include guarantees issued between parents and their subsidiaries or between corporations under common control, a parent's guarantee of its subsidiary's debt to a third party, and a subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

4. Should benefits that an employer provides to its employees that otherwise meet the definition of an insurance contract be within the scope of the proposed guidance? Why or why not?

No, employer-provided benefits should not be included within the scope of the proposed guidance as they are not intended to generate underwriting profits for the employer and are considered a component of employee compensation expense. Additionally, there have been no significant issues noted with accounting for these benefits under existing standards.

5. The Board's preliminary view is that participating investment contracts should not be accounted for within the proposed model for insurance contracts but, rather, should be included in the scope of the proposed model for accounting for financial instruments. Do you agree? Why or why not?

No response.

6. Do you support the approach for determining when noninsurance components of contracts should be unbundled? Why or why not?

No, through discussions with industry peers, we have encountered widely differing interpretations of the unbundling principle and related examples provided in the proposed guidance, in particular for account balances. If retained in the final standard, this confusion could result in divergence of industry practice resulting in a lack of comparability. To alleviate this confusion, we support a clearer principle and examples within the guidance. This modified principle should only require unbundling when it does not result in arbitrary allocations between the insurance and non-insurance components. We believe embedded derivatives that require bifurcation under current guidance (e.g. equity indexed annuities and living benefits such as guaranteed minimum account balances) and goods and services combined with a contract for reasons that have no commercial substance are the only items that would not result in arbitrary allocations between insurance and non-insurance components and should be the only components required to be unbundled.

Additionally, it is not clear how unbundling and the unit-linked contract presentation interact. IASB exposure draft paragraph 8, outlines the criteria for unbundling and paragraph 78, outlines the special presentation; some interpret these two paragraphs as requiring the passage of one for the other to be applicable. Conversely, others view these paragraphs as independent of each other. We support the second viewpoint that the paragraphs should be independent of each other which would result in a unit-linked contract qualifying for the special presentation regardless of if it is unbundled and accounted for within other standards or within the insurance contracts standard. We request the guidance be clarified to note this.

Furthermore, it is unclear the presentation that paragraph 78 is requiring and how to treat gains and losses on the transfer of assets from the general account to a unit-linked contract. We suggest this paragraph be redrafted consistent with FASB guidance as codified from Statement of Position 03-1 Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts as follows:

Unit-linked assets should be measured at fair value and reported in the insurance enterprise's financial statements as a summary total, with an equivalent summary total reported for related liabilities. The related investment performance (including interest, dividends, realized gains and losses, and changes in unrealized gains and losses) corresponding amounts credited to the contract holder should be offset within the same statement of operations line item netting to zero. Assets transferred from the general account to a unit-linked contract should be recognized at fair value to the extent of third-party contract holders' proportionate interest in the unit-linked contract. Any resulting gain related to the third-party contract holder's proportionate interest should be recognized immediately in earnings of the general account of the insurance enterprise, provided that the risks and rewards of ownership have been transferred to contract holders using the fair value of the asset at the date of the contract holder's assumption of risks and rewards.

7. Do you agree with the use of the probability-weighted estimate of net cash flows to measure insurance contracts? Does that approach faithfully represent the economics of insurance contracts? Is it an improvement over existing U.S. GAAP?

No, while we agree with the notion that the proposed measurement approach is a faithful representation of the economics of an insurance contract, we are unconvinced that a literal interpretation of this approach, which would consider every possible scenario, regardless of its likelihood or determinability, is an improvement over existing U.S. GAAP. The actuarial methods currently in use today derive an expected value or mean and already produce unbiased estimates of the probability of relevant scenarios, which we believe satisfies the intent of the proposed measurement model. In the property and casualty insurance industry, this method is known as the "actuarial central estimate," and while it does not consider all possible scenarios, it incorporates the *relevant* scenarios that can be identified and quantified and does <u>not</u> rely on the subjective interpretation inherent in measuring remote outcomes. For these reasons, we recommend that the Board endorse further guidance within the measurement model to support the actuarial central estimate and other similar methods.

8. Do you think that an entity's estimate of the net cash flows should include a risk adjustment margin?

No, we support the use of the composite margin. While we understand the theoretical benefits of a risk adjustment, we are concerned the costs of a dual margin approach outweigh the benefits. Specifically, we are concerned that the techniques used to estimate the risk adjustment are too subjective and could result in inconsistency between insurers' financial results. The composite margin would eliminate the need to use subjective methods that decrease comparability as it is calibrated to inflows and outflows at inception of a contract.

9. Is the objective of the risk adjustment margin understandable? If so, do you think that the techniques for estimating the risk adjustment margin (see paragraph 52(b)), faithfully represent the maximum amount that the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected?

No, as discussed in question 8, we support the use of a composite margin as the techniques for estimating the risk adjustment margin are too subjective.

10. Do you think that the risk adjustment margin would be comparable for entities that are exposed to similar risks?

No, as discussed in question 8, we support the use of a composite margin as the techniques for estimating the risk adjustment margin are too subjective which may result in inconsistency between insurers' financial results.

11. Do you agree with the description of cash flows that should be included in the measurement of an insurance contract? Is the proposed guidance operational?

No, we recommend that the measurement model include "other assessments" as allowed in Accounting Standards Codification (ASC) 944-30-35-5 so that revenue-sharing contracts with underlying mutual funds and management fees associated with unit-linked contracts may be considered in the cash flows. In response to the second part of this question, we consider the guidance provided regarding which cash flows to include in the measurement of an insurance contract to be operational.

12. Do you agree that the carrying amount of all insurance contracts should be discounted if the effect is material? Do you agree with the proposed guidance on the discount rate that should be used to measure the carrying amount of insurance contracts? If not, which discount rate should be used?

No, we do not agree that the carrying amount of all insurance contracts should be discounted. Specifically, we do not agree with the proposal to discount the preclaims liability of a short duration contract. The minimal benefit that may be gained by discounting the pre-claims liability, only to accrete the liability over a very short period of time would not support the added costs of doing so.

No, we also do not agree with the proposed guidance on the discount rate that should be used to measure the carrying amount of insurance contracts. A significant portion of insurance business consists of long-term, illiquid liabilities that are priced and managed in concert with the assets backing them in order to provide for the ultimate cash flows along with a provision for profit. The requirement that such business be valued using a risk-free discount rate will lead to significant accounting losses at issue that are not representative of the economics of this business that is reasonably expected to be profitable in the long run. Other portfolios of insurance business are more market-sensitive and may be managed as such, in which case a marketconsistent discounting method that makes use of risk-free rates may be appropriate. Accordingly, the guidance should not prescribe the method to be used to calculate the discount rate, nor should it prescribe the requirement to use the discount rate as of the reporting period (unlocking the discount rate) nor should it prescribe the requirement to use the discount rate in existence at inception of a product (locking the discount rate). The guidance should incorporate a principle that the methodology used to calculate the discount rate and the requirement to lock or unlock the discount rate should be based on their business model, including asset-liability management and the nature of the underlying liabilities. This decision should be made at a level consistent with how management applies the strategies.

13. Do you think that acquisition costs should be included as one of the cash flows relating to the contract? If not, how would you account for acquisition costs?

Yes, we agree that acquisition costs should be included in the fulfillment cash flows.

14. Do you agree that acquisition costs included in the cash flows used in the measurement of the insurance contract should be limited to those that are incremental at the individual contract level? If not, which acquisition costs, if any, would you include in the measurement of the insurance contract?

No, we support the definition of acquisition costs in the Financial Accounting Standards Board issued ASU No. 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts and propose that incremental acquisition costs be measured at the portfolio level rather than the individual contract level. We believe that the definition of acquisition costs in ASU 2010-26 better reflects the nature of how insurance business is acquired both for new and renewal business. We believe that instead of the requirement to be incremental at the individual contract level a portfolio approach would be more appropriate. This could be achieved easily based on standard costing and other methods aimed at identifying acquisition costs for a group of policies. ASU 2010-26 provides that standard costing methods such as actual costs, job process costs, and job order costs may all be used in combination to identify acquisition costs for successful contracts across a portfolio of contracts. Additionally, a portfolio approach for acquisition costs would be consistent with the other aspects of insurance liability recognition within the proposed guidance. Furthermore, we are concerned that if the guidance is finalized as currently proposed this will lead to the U.S. insurers bearing a very costly burden to implement changes in the acquisition cost processes multiple times in a short period of time.

15. Do you agree with the use of either the composite margin approach or two-margin approach to measure the net insurance contract? Does either approach faithfully represent the economics of insurance contracts? Is either approach an improvement over the measurement used in current U.S. GAAP?

As previously mentioned in our response to question 8, we support the composite margin approach. See our response to question 32, regarding whether the guidance in an improvement over current U.S. GAAP.

16. Do you think that the composite margin should be recognized in earnings in subsequent periods using the ratio described in paragraph 83? If not, how would you recognize the composite margin in earnings?

No, while the FASB formula is preferable to the IASB proposal because it allows for the release of the margins partly in proportion to expected claims and benefits and partly in proportion to exposure (as used to allocate premiums) and therefore results in less back-ending of profits than the IASB proposal, we offer another alternative. We suggest the Boards consider a method that releases the margin entirely based on exposure. For example, we suggest the use of projected in-force, such as the annuity account balance or a life insurance death benefit, to drive the release of the margin. Additionally, we support allowing changes in assumptions within the cash-flows that result in volatility to first be applied to the remaining margin that has yet to be released prior to the change in assumptions affecting the income statement. This buffering method would better portray the results of the business by removing short-term volatility that is not reflective of the economics of the business.

17. Do you agree that interest should not be accreted on the composite margin? Why or why not?

Yes, we agree with the Board that interest should not be accreted on the margins if the formula for releasing the margins is retained. As noted in our response to question 16, we are concerned the FASB formula and IASB proposed method could result in the back-ending of profits, which accretion would further skew. If the methodology for releasing the margin were modified as we suggest, then accretion is less of a concern.

18. Do you think that all insurance contracts should be recognized and measured using one approach or that some insurance contracts should be recognized and measured using an alternative approach (for example, the modified approach)? Why or why not?

We support using separate approaches for short and long duration contracts. However, we oppose any method which delineates those contracts strictly with the use of a time-based bright-line. We think the 12-month rule is arbitrary and incompatible with insurance coverage and pricing options, particularly in the property and casualty business. As such, we recommend that the Board consider keeping the principles-based definitions that focus on the purpose of the insurance contract. If the Boards decide to retain the current bright-line with regards to coverage period, then it is our belief that this will result in a new model that is less useful than existing accounting standards, resulting in less relevant and understandable information for our financial statement users.

19. If an alternate approach is required for some insurance contracts, what recognition, measurement, and presentation provisions should be applied (including those items noted in paragraph 106)?

In general, we support the modified measurement approach and propose a few alternate recommendations that address issues we see related to discounting, the onerous contract test, and presentation. As it relates to discounting the pre-claims liability, we do not think this would be meaningful to financial statement users since

the duration of this liability is short and not as sensitive to interest rate fluctuations. Ignoring the effect of discounting would also be consistent with the recently issued IASB/FASB Exposure Draft on Leases which does not require discounting for short-duration leasing arrangements.

In regards to the onerous test We agree with the underlying principles supporting the use of an onerous contracts test. Overall, the benefits of this requirement are that it is conservative and would discourage companies from using an overly-aggressive and risky growth strategy to boost short-term profits. However, we disagree with certain aspects of how the test is performed under the proposed model that we believe are unnecessarily cumbersome or that may distort the underlying economics associated with short-duration contracts. We believe that the level of aggregation required for the testing is at a far too granular level. Any benefit that is believed to be gained from performing the onerous contract test at such a disaggregated level would not exceed any reasonable cost-benefit threshold. Additionally, requiring the use of present value techniques for performing this test for short duration business adds unnecessary additional complexities for little to no benefit. Alternatively, we propose the Boards consider modifying the onerous contracts test so that it is performed in a similar manner as the premium deficiency testing that is performed under existing U.S. GAAP requirements. We believe that in doing so the test would still achieve its desired aim while not being overly complex.

In terms of financial statement presentation, we agree with the presentation of premiums and incremental acquisition costs on the statement of comprehensive income, but we believe that it should be required instead of optional for the sake of comparability and consistency within the industry. We also support a requirement to include premiums in course of collection on the statement of financial position. This metric is valuable to financial statement users who want to understand how effectively a company is collecting premiums.

The only proposed item that we do not think should be required on the face of the statement of comprehensive income is non-incremental acquisition costs. Given that there is minimal guidance on what qualifies as a non-incremental cost, we believe in practice there would be a lack of comparability in the types of expenses that would be included in this amount and as such it would not be meaningful. Furthermore, we think that the additional operational effort of breaking out these expenses outweighs the benefit to financial statement users of seeing them reported separately.

20. Do both the building-block approach and the modified approach (with the latter approach applied only to certain short-duration contracts) produce relevant and decision-useful information? Why or why not?

No, the guidance as proposed does not produce relevant and decision-useful information given the concerns we outline in the other questions within this Appendix. We are, however, supportive of a model that uses expected cash flows.

21. How should the scope of insurance products for each approach be defined (for example, duration of coverage period, duration of claims payment period, or type of insurance)?

We think the scope of insurance products should be defined for each approach using a principles-based definition which focuses on the purpose and nature of the insurance contract. See response to question 18.

22. Are there specific types of insurance contracts for which the approaches would not provide decision-useful information?

Yes, we do not believe that either measurement approach would provide decisionuseful information for financial guarantee contracts, employer-provided benefits or credit default swaps. See our response to questions 3 and 4 for further explanation.

23. What are the implications of the recent U.S. healthcare reform to the application of the proposed contract boundary principle, including whether health insurance contracts written under the new reforms would meet the conditions in the proposed guidance to be accounted for under the modified approach?

No response.

24. What other changes should be considered to both improve and simplify U.S. GAAP for short- and long-duration insurance contracts?

See response to question 32.

25. What are the incremental costs of adopting the alternatives described in this Discussion Paper? Please separately describe one-time costs and ongoing costs.

No response.

26. The scope of the proposed guidance includes reinsurance contracts that an insurer issues or acquires. However, insurance contracts held directly by other policyholders would be excluded from the scope of the proposed guidance. Do you agree with this exclusion? Why or why not?

See response to question 3.

27. Should there be symmetry between the recognition and measurement of reinsurance contracts and the underlying contract ceded?

Yes, we believe the measurement of the reinsurance contract asset, should be performed using the same principles and methods used in the measurement of the underlying contract being reinsured (i.e., for liabilities for ceded insurance policies measured using the modified measurement approach any related reinsurance asset should be measured using a modified measurement approach and vice versa). This does not imply that the parties will arrive at the same answer. understand it is the Boards' intent to allow for the use of the modified measurement approach in measuring reinsurance assets, paragraphs 43 – 45 do not seem to convey that intent. It follows then also that it is unclear when the modified approach could be applied. For example, it is unclear whether a 12-month risk-attaching contract covering one year policies, but having an aggregate coverage period spanning two years, would be accounted for under the modified approach. Likewise, it is unclear whether yearly renewable term reinsurance on a universal life policy that has a 12 month coverage period would be accounted for under the modified or building blocks approach. It is our recommendation, however that the reinsurance asset always be accounted for under the same approach as the underlying contracts being ceded.

We would also like to express our concerns regarding the contract boundary specifically as it pertains to risk-attaching reinsurance policies. Because the contract boundary as proposed would require recognition of the reinsurance asset upon the bind date it seems that the ceding company would need to project cash flows, estimate building blocks and set margins based on expected cash flows before the direct policies have been written.

Additionally, we recommend the Boards reconsider their proposal for consideration of non-performance risk by the reinsurer on an expected value basis when estimating the present value of cash flows. We believe that this requirement will in turn require the evaluation of reinsurance assets at a very granular level, which in most cases would not allow for a true symmetry in the portfolio underlying the measurement of the underlying ceded policies and the related reinsurance assets. We advocate the use of an incurred loss model as is prescribed under existing accounting standards. Under the incurred loss model, credit losses are recognized only when those losses have been incurred, as there is evidence that the losses are probable and estimable.

More importantly, however, we ask the Board for further clarification on reinsurance overall. Given the wide variety of complex reinsurance arrangements that exist, we think the limited guidance contained in the Discussion Paper would not support a reliable framework for the valuing, auditing, or reporting of reinsurance transactions. This is a concern for financial statement users who want to understand how effectively an entity uses reinsurance and for companies that rely on reinsurance to manage their underwriting results and mitigate risk.

28. The margin presentation approach highlights the changes in the insurance liability, rather than the current approach in U.S. GAAP, which presents, among other items, premium revenues, benefits paid, operating costs, and changes in loss estimates. Would this change improve your understanding of the performance of an entity that provides insurance (for some types of insurance or for all)? Please explain.

No, we do not believe that the margin presentation would improve users' understanding of an entity's performance. Much of the information absent in the margin approach such as premium revenues, benefits paid, and operating costs is used to assess an entity's sales performance, relative growth, and claims experience and should be given equal prominence on the face of the financial statements. Only providing this information in the footnotes may complicate the users' ability to assess the financial outlook of an entity and is such a significant change from the current presentation of premiums, claims, benefits payments and expenses that it would require substantial effort to educate users of the financial statements. Further, we think the lack of a "sales volume" metric on the face of the financials puts entities that sell insurance at a disadvantage in explaining their results to analysts compared to other companies that report top-line revenue results. While we agree that the presentation should flow from the measurement of insurance contracts, we emphasize that the cash inflows and outflows are as essential to understanding the performance of these contracts as the margin components, and therefore warrant equal prominence on the face of the financial statements.

29. Should insurance contracts measured under the building-block approach be presented using a margin presentation approach or a premium presentation approach that would require a true-up amount as described in paragraph 119 (for example, the written allocation presentation approach or the allocated premium presentation approach)?

We believe that insurance contracts measured under the building-block approach should be presented using a premium presentation approach that would require a true-up amount as described in paragraph 119. In our view, a premium-based presentation approach would represent a superior presentation view to the summarized margin approach as it presents such key performance metrics as premiums, claims, benefit payments, and expenses on the face of the financial statements.

Additionally, we believe that the recognition of premiums as deposits receipts, benefit payments and expenses as repayments of deposits would be a fundamental change to current practice which will result in a loss of essential information for users of financial statements and will require a substantial effort to educate users. Therefore, we believe that the written premium approach found in the FASB DP would represent a better presentation view than the summarized margin approach as it presents such

key performance metrics as premiums, claims, benefit payments, and expenses on the face of the financial statements.

We further recommend that the non-incremental acquisition costs not be disclosed as a separate line item on the face of the Statement of Comprehensive Income as there is no guidance on how these costs are to be defined and as such there is likely to be diversity in practice as to the interpretation of which costs would appropriately fall into this category. This in turn will result in lessened comparability in the financial statements. Furthermore, we think that the additional operational effort of breaking out these expenses outweighs the benefit to financial statement users of seeing them reported separately.

30. Should short- and long-duration (or nonlife and life) contracts be presented in a similar manner even if such contracts are measured under different approaches?

We support a common presentation approach for short and long-duration (or nonlife and life) contracts even if they are measured under different approaches. We think having two different presentation models would further complicate the ability of financial statement users to compare peer companies and assess the performance of an entity, especially for insurers of both short- and long-duration products.

Furthermore, we think the written presentation approach proposed in question 29 will capture the relevant information for long-duration contracts while also accommodating the presentation of revenue, claims and expenses incurred, and amortization of incremental acquisition costs required by paragraph 75 of the IASB Exposure Draft for short-duration contracts.

31. Do you agree with the proposed disclosures in the IASB's Exposure Draft? Why or why not? If not, what would you recommend and why?

We do not agree that the exorbitant amount of disclosures will help the financial statement user better understand the financial position of the company and question the highly prescriptive nature of some of the requirements. We think the amount of information in its totality will inundate users with insignificant details and distract them from meaningful points of analysis. In particular, the measurement uncertainty analysis defined in paragraph 90(d) of the IASB Exposure Draft is not only exceptionally onerous, but also open-ended, providing little context to the user as to how the information may be extrapolated to evaluate the performance or exposure of an entity. Given the numerous assumptions to consider (e.g., lapses, mortality, expenses, utilization rates, etc), we think having to hypothesize and calculate other reasonable inputs is more of an actuarial exercise than a meaningful glimpse into the financial condition of an entity. For these reasons, we do not think this information

is going to be meaningful to financial statement users and respectfully ask the Board to reconsider whether this information necessitates disclosure.

Along the same lines, we are concerned with the requirement to disclose a sensitivity analysis of insurance risks in paragraph 92(e)(i) and a similar analysis on market sensitivities in 96(a). Both of these analyses will require a significant amount of time and preparation, which, in many cases, may not be feasible within the financial statement reporting timeframe. More specifically, however, we are concerned with paragraph 93(a) of the Exposure Draft which requires an entity to disclose a summary of the risk management techniques and methodologies developed internally to mitigate exposure to non-insurance risks. We think this requirement blurs the distinction between information that is appropriate for public consumption versus information that an entity should be given discretion to keep confidential. In light of these considerations, we propose that these disclosures be required on an annual basis and in quarters where the reporting entity has had a significant change in their risk management techniques and methodologies as well as the inclusion of an option to omit information deemed proprietary in nature. This would limit the operational burden of having to disclose this information for each interim period while also respecting the confidentiality of certain internal risk management practices.

In addition, as it relates to the claim development disclosures required in paragraph 92(e)(iii), we ask the Board to consider requiring this disclosure on a prospective basis beginning on the date of adoption. This means that the start of the ten-year data capture on claims development would begin upon transition and build up to the ten year cutoff from there, as opposed to looking back a full ten years from the date of adoption to compile the disclosure. Considering the various reporting, actuarial, and information technology changes that will likely be required to implement the proposed guidance, we believe this recommendation would help ease transition and mitigate operational burdens during the implementation process.

Furthermore, while we do not support the two margin approach, we are concerned with the requirement in paragraph 90(b)(i) to disclose a confidence level for the conditional tail expectation and cost of capital methods of measuring the explicit risk adjustment.

For portfolios of business where a confidence level approach is not appropriate it follows that any disclosure of a "corresponding" confidence level disclosure does not make sense. This would not provide a true basis for comparison across companies and portfolios as intended, but rather may serve as a potentially misleading data point. Furthermore, the cost of capital method does not normally derive estimates using confidence levels, and in order to comply with this disclosure, companies would have

to rely on subjective assumptions and untested processes to derive a confidence level that would not be a natural corollary of this technique. As such, we do not believe this would disclosure would result in relevant and decision-useful information for the financial statement users.

- 32. After considering your views on the specific issues contained in this Discussion Paper and the IASB's Exposure Draft, what do you think would represent the most appropriate improvement to U.S. GAAP?
 - a. Pursue an approach based on the IASB's Exposure Draft?
 - b. Pursue an approach based on the IASB's Exposure Draft with some changes? Please explain those changes.
 - c. Pursue an approach based on the Board's preliminary views in this Discussion Paper?
 - d. Pursue an approach based on the Board's preliminary views in this Discussion Paper with some changes? Please explain those changes.
 - e. Make targeted changes to address specific concerns about current U.S. GAAP (for example, items included in paragraph 7)? Please describe those changes.

While we are supportive of the overall objective and purpose of the joint project between the FASB and IASB (collectively the Boards) to achieve convergence for insurance contracts, we do not believe these goals will be achieved through adoption of the guidance as proposed. Furthermore, we strongly believe the complexity of modifications as proposed requires significantly more analysis in order to minimize unintended detrimental impacts to the reliability of information utilized by investors. Given the importance of this guidance, we respectfully request the Boards modify their project plans and timelines to ensure convergence through thoughtful redeliberations and reconciliation of differing views. Furthermore, it is imperative that more robust field testing is performed taking into consideration an expansive range of scenarios and assumptions to better understand how the proposed model will respond. While expediting a standard is important, achieving a high-quality standard which is beneficial for both investors and industry participants is critical.

We also respectfully request that the Boards more heavily weigh the economic impact to preparers and users of financial statements from issuing non-convergent guidance. Accounting changes to insurance contracts are complex and require significant operational and information technology changes. We realize that implementation and training costs for accounting guidance changes are a necessary cost of business. Many companies, including Nationwide, believe that these costs can be significantly reduced if joint guidance issued by the Boards is aligned. We are very concerned

with the prospect of implementing changes multiple times over a relatively short period of time to comply with US GAAP modifications with subsequent conversion to IFRS. This scenario would be very costly for reporting insurance companies with a downstream detrimental impact to investors and policyholders.

While striving for convergence, the Boards should coalesce around a model which better reflects the economics of the insurance business. For many products, unlocking the discount rate creates volatility in earnings not reflective of management's expectation of profit and loss emergence. Also, requiring the use of a mandated discount rate which is not indicative of pricing methodologies could result in day-one accounting losses on economically profitable products. requirements as well as others identified in our comment letter are retained in the final standard, insurers may change behavior to manage financial statement accounting volatility resulting in additional costs to be borne by policyholders. For example, management may choose to purchase new hedging instruments simply to dampen accounting volatility created by the proposed standard. management may reduce the availability or change the pricing of products, such as spread-based life and annuity products, to achieve a more accurate pattern of accounting earnings that does not reflect day-one accounting losses. We prefer an accounting model that is more reflective of our business economics so that downstream pricing and product availability impacts are minimized.

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