Kelvin Sederburg, ACAS, MAAA
300 33rd Street
West Des Moines, IA 50265-4010

October 7, 2013

Technical Director
File Reference No. 2013-290
FASB
401 Merrit 7,
PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2013-290: Proposed Accounting Standards Update - Insurance Contracts (Topic 834)

Dear Members of the Financial Accounting Standards Board,

Thank you for the invitation to comment on the FASB Insurance Contracts (Top 834) Exposure Draft (ED). I am a credentialed property/casualty (P&C) actuary with 25 years experience in the industry, working exclusively at the company level. I perform reserve adequacy evaluations, advise management on amounts to book for carried IBNR, prepare documents for financial statements, and sign the NAIC Statement of Actuarial Opinion for Loss and LAE Reserves for a insurance group consisting of seven primary companies and one reinsurance company. I sometimes review competitors' financial statement filings. I am familiar with statutory and GAAP accounting, and have experience working for a mutual insurance company which owns a downstream stock company. My comments will relate specifically to the ED's impact on short-duration contracts

Having thoroughly reviewed and considered the proposed guidance, I must sincerely and earnestly ask the Board to **reject** the proposed guidance in favor of retaining the current standard for short-duration contracts as **the proposal is inferior on several grounds of concern to several sets of constituents:**

1. Users: The proposed guidance **does NOT increase decision usefulness and comparability** across issuing entities of information about an entity's insurance liabilities; specifically regarding the nature, amount, timing, and uncertainty of cash flows associated with those liabilities. In fact, nearly all of these items are rendered more opaque.
2. The P&C Industry (Actuaries, Insurance Companies, Insurance Regulators and Insurance Consumers): The proposed guidance's **measurement objective for establishing insurance liabilities as an unbiased probability weighted expected value (i.e. "statistical mean") is not sound actuarial, business, or regulatory practice** and increases the risk of insolvency by mandating reserves be carried at what many consider to be the lowest reasonable point within a range of reserve scenarios.
3. Preparers: The proposed guidance represents an **exponential increase in the resources needed to complete accurate financial reporting in a timely manner**. Systems will need to be upgraded to track and calculate several variables which are currently unneeded and unused by management. Expertise will need to be developed or hired in order to make the several subjective judgments required each reporting period.

Each of these issues is discussed in detail in the section that follow, but the bottom line is that the proposed guidance is **not an improvement on the current standard**, and contains, in my humble opinion, several serious flaws. I am aware that the vast majority of property/casualty respondents to FASB's 2007 agenda proposal voiced the opinion that the current short-duration contract standard and associated disclosures are not in need general revision. I am also aware of the response to the FASB 2010 discussion paper, where thirteen of seventeen letters from P&C companies urged FASB to abandon the requirement for discounting and had very grave concerns regarding the proposed guidance. Having evaluated the exposure draft, I too, must add my voice and actuarial concerns to the debate. The Board has expended a great amount of effort to develop the proposed guidance and is to be commended for its careful consideration and thorough examination of the issues. ***However, the Board must be courageous enough to not let the momentum of this project displace the clarity, comparability, simplicity and elegance of the current standard for short-duration contracts which has been vetted through numerous economic cycles, is well accepted by preparers and users alike, and serves as a harmonious complement to the regulatory needs of statutory accounting.***

Users: Decision Usefulness and Comparability

There is not necessarily one single issue which degrades the decision usefulness and comparability of the proposed guidance relative to the current standard. Rather, it is the interaction of three new variables: (1) portfolio definition/construction, (2) "estimated" cash flow patterns by portfolio, (3) applying a subjective discount to the "estimated" cash flow pattern. Each is discussed in turn and interactions examined.

Portfolio Definition/Construction

This variable may be the least problematic but still raises issues. The proposed guidance does allow for some flexibility in portfolio construction subject to certain restrictions (such as not combining dissimilar products even if the duration and release from risk standards are met). The construction of portfolios is allowed on a wide basis of granularity or non-granularity by coverage and geographic region. Also allowed is the grouping of multiple issuance years. While flexibility in portfolio construction is a good thing, the result may lessen comparability between entities. At the same time, the restrictions may force entities to measure results by groupings which are different than the divisions which management organizes segments for making operating decisions and assessing performance.

Further, if the restrictions on portfolio construction in 834-10-55-47 & 48 are rigidly interpreted, it could lead to the construction of portfolios for which the sparseness of data renders their use not credible for the task of determining expected cash flows. Consider a small insurance company which heretofore combined the auto physical damage data from its commercial and personal auto writings to evaluate reserves in order to enhance data credibility. Or consider another small writer which combines all commercial casualty lines like workers compensation and commercial general liability to obtain reserving data that has some amount of credibility. Both examples may not be allowed under the proposed guidance.

There is even a more fundamental issue with the definition of a portfolio. The proposed guidance defines portfolios in terms of "contracts". The most widely used P&C reserving methodologies employ calendar year premiums and accident year losses (i.e. claims grouped by date of occurrence). Basis for Conclusion 123 (BC123) betrays confusion as it states that "entities generally group contracts by … accident year for non-life companies." This is not true. Non-life companies group "claims" by accident year, not contracts. The calendar-accident year aggregation does not match the premium and losses (the cash flows) on a contract basis. This faux pas is a prime example of the attempt to graft the measurement of short-duration contracts onto a standard written for long-duration contracts. Are insurance entities being directed to measure portfolios of contracts or portfolios of claims?

One final issue concerning portfolio construction and comparability of results must be pointed out. Section 834-10-55-50 clearly states that portfolios can cover several contract issuance years. BC355 appears to state that the accretion discount rate will be determined by the portfolio inception (in contrast to 834-10-35-24 which refers to "contract inception"). It is safe to say that for most P&C lines of business, the duration and patterns of release from risk have not and do not vary significantly over time (years, perhaps decades). Would it be allowable to construct a portfolio containing contracts issued over the last five decades and use an accretion rate fifty years old?

Estimated Cash Flow Patterns by Portfolio

The deterministic methods used by P&C actuaries can sometimes project the ultimate value of some group of claims with a reasonable amount of certainty, but all actuaries would admit that the realized value will often deviate, sometimes substantially, from the projection. The ultimate loss realized for portfolios of short-tailed property claims generally show little variability from initial estimates, while ultimate losses for portfolios of longer-tailed casualty claims exhibit much greater variance from the original projection. For some portfolios, such as asbestos and pollution mass torts, traditional methods fail and it is extremely difficult to estimate an ultimate with any degree of certainty. The point is that estimating ultimate losses for any group of claims involves uncertainty. The ultimate estimate will change over time as the group of claims mature and gradually converge with the actual ultimate.

Whatever the variation that may be expected in estimating ultimate losses, much greater variation (and much less precision) must be anticipated when estimating loss payment pattern. The estimation of ultimate losses is an exercise which requires assumptions and calculations concerning two variables, the occurrence of a claim (frequency), and the ultimate value of that claim (severity). Estimating a payment pattern requires assumptions and calculations regarding a third variable, the timing of the claim payment (if any). The variance expected when estimating a payment pattern will be greater than that associated with simply estimating ultimate losses.

Most P&C companies are more concerned with estimating the ultimate loss for a group of claims/policies than with determining an estimated payment pattern. The current use and importance of estimating payment patterns probably varies significantly by company. Some companies may estimate a pattern only as needed for regulatory reporting while others may perform detailed analysis. Mutual companies are generally far more concerned with reserve adequacy than with the timing of claim payments.

Adding to the complexity of estimating loss and loss adjustment expense payment patterns, the proposed guidance requires the estimated timing of cash flows on items such as anticipated dividends, ceded recoveries, anticipated salvage and subrogation, assumed reinsurance reinstatement premiums, and whatever other cash flows are required to fulfill the contract. It is likely that few, if any, companies have current data aggregations systems that can summarize the timing of these transactions. The data for some transactions may be so sparse as to render their use in estimating a payout pattern not credible.

To summarize the issues associated with developing an expected cash flow pattern, uncertainty prevails not only in the estimation of ultimate losses, but to a much greater extent in estimating the timing of the payment of losses and of all the other contract fulfillment elements. A liability accounting measure which is based on measuring cash flows rather than the ultimate liability introduces more judgment, subjectivity and variation. While the exercise might appear to imply more precision to the liability estimate, in reality the accuracy of the estimated ultimate has not increased while variability of the estimate over time has increased. One of the goals of the proposed guidance is to increase decision usefulness and comparability across all issuing entities with regard to the information about an entity's insurance liabilities regarding the uncertainty of cash flows of those liabilities. It does not appear any actual information about uncertainty is conveyed. In fact, it appears more precision and less uncertainty is implied. The estimate itself is more uncertain than the current standard would produce.

In BC346a the Board states that "The uncertainty of an insured event occurring and the amount at which an insured event is settled is the nature of insurance. This uncertainty, however, does not relate to including the time value of money in the measurement of the liability for incurred claims." Actually, it has everything to do with recognizing the time value of money because, without a payment pattern and an ultimate loss estimate, both of which have associated uncertainty, discounting is impossible.

In BC346b it is stated that the Board "… observed that other industries also are required to reflect the time value of money in the measurement of their liabilities. The Board decided that an exception should not be made for a sector of the insurance industry, especially if the effect of discounting could be more material than in other industries." Other industries do not experience the uncertainty in the timing and amount of cash flows which the P&C insurance industry has. It is precisely because the timing and amount of cash flows are so far more uncertain than other industries that an exception should be made. The effect of discounting may, at times, be material. The resulting error in measurement would be even greater.

Application of a Subjective Discount Rate

As with the construction of portfolios, the proposed guidance gives latitude to the means by which a discount rate could be selected. And like portfolio construction, while flexibility is generally beneficial to preparers, it degrades comparability for users. Most users of P&C financial statements are far more concerned with the adequacy of carried reserves and desire to work with nominal incurred and paid losses to evaluate nominal reserves. Users would prefer to apply their own discount rates to determine expected future profitability and will likely demand enough disclosures to return financial data to an undiscounted basis. Users understand that discounting is an economic construct. There is no liquid market for short-duration contact liabilities and the selected discount rate may or may not be realized (just as the estimate ultimate loss payments on a portfolio of insurance contract may or may not be realized).

One could also question what the discount rate is supposed to represent. Even if a specific rate, like a corporate AA bond were prescribed for use, what exactly does the discounted value mean? Whether subjective as stated by the guidance or prescribed by an external measure, the rate is probably not representative of the rate that would be used if a P&C insurance entity were to be valued. In that situation, each entity would require its own unique rate to reflect its own unique risks. If the discount rate is to be representative of the value of a portfolio of insurance contracts, the abstraction is even greater as there would be no apparent consideration given to the correlation with other portfolios that exist at the entity level (either the seller or the buyer). It would appear discounting is being required for the sake of discounting only, and not because there is any particular meaning or value associated with the resulting liability.

Cumulative Impact of Portfolio Construction, Estimating Cash Flow Patterns, and Subjective Discounting

The comingling of subjectivity and variability associated with portfolio construction, "estimated" cash flow patterns and discounting very seriously erodes the decision usefulness and comparability of the proposed guidance relative to the current standard. Discounting by itself is admittedly sound economic theory *if the timing of cash flows can be determined with a high amount of certainty.* While this may be possible with the types of products associated with long-duration contracts, loss payout patters are quite variable in short-duration P&C contracts. In some cases, like mass tort asbestos and environmental claims, there is not even a model or method which has proven to be accurate or even widely accepted for determining the ultimate loss, let alone the payout pattern. The variability and uncertainty of the payout pattern, and the uncertainty surrounding the actual nominal ultimate, renders any perceived value associated with subjective discounting as quite dubious. The calculation presents the façade of precision and meticulous application of economic theory while the result provides no information about cash flow uncertainty and creates artificial volatility in the earnings measurement.

The Board's axiom regarding the time value of money may be good economic theory, but applying discounting to "uncertain" cash flows does not necessarily provide users with better information nor does it improve comparability (especially in terms of reserve adequacy) than would the nominal liability amounts required under the current standard. The Board's desire to have a standard that provides useful and comparable information to users must be the primary objective. The Board's axiom concerning the time value of money should be a secondary consideration when its application actually works against the objective. As stated earlier, the vast majority of agenda proposal and discussion paper comment letters from P&C financial statement users and preparers expressed a preference either to retain the current standard or to exclude discounting from the proposed standard.

P&C Industry: Impact on Reserve Adequacy, Solvency and Industry Practices

The proposed standard's guidance clearly states that the fulfillment cash flows measurement objective is "the expected value, or statistical mean of the full range of possible outcomes." For P&C portfolios subject to the Premium Allocation Approach, no explicit margin is allowed and, literally read, the measurement objective leaves no room for an implicit margin (conservative assumptions). The imposition of "discounting" in addition to the objective leaves no implicit margin from anticipated investment income, as the Board correctly observes in BC347. This is a very troubling issue for most P&C actuaries and companies for several reasons.

Targeting the mean of a statistical distribution with no margin for uncertainty is considered by many to be unsound actuarial practice. In the Spring 2007 Casualty Actuarial Society "Variance" journal, Mark R. Shapland, FCAS, MAAA argues convincingly that, if determinable, the "statistical" mean should represent the lower bound of reasonableness ("Loss Reserve Estimates: A Statistical Approach for Determining "Reasonableness"). Stochastic modeling is still an evolving practice in P&C reserving. Most actuaries rely on tried and true deterministic loss development methods to determine a "reasonable range" (note that these methods generally determine the ultimate expected loss, not cash flow patterns). P&C actuaries are very aware of the variability of ultimate loss estimates and are also aware that insurance regulatory authorities and the market look unfavorably upon "adverse" loss development (that is, actual reported losses in excess of the original "estimate"). P&C actuaries must also sign a Statement of Actuarial Opinion concerning the reasonableness of an entities loss reserves. This statement carries a "public" responsibility and the actuary can be subject to personal disciplinary actions if negligent in the performance of his/her professional duties. Given these factors, P&C actuaries and insurance entities generally do not desire to live on the knife's edge of reserve adequacy, but prefer to consider the uncertainty of potential outcomes when determining ultimate loss estimates.

The proposed guidance is also at odds with current statutory accounting guidance which explicitly encourages the reflection of potential negative outcomes when estimating claim reserves (SSAP 55). Insurance industry regulators and insurance rating firms, such as AM Best look favorably on sound reserving practices. AM Best's 2004 research ("Best's Insolvency Study - Property Casualty U.S. Insurers 1969-2002) points to deficient loss reserves as the primary cause of 562 P&C insurer insolvencies during the study period. As already stated, it is extremely difficult to estimate an ultimate loss for asbestos liabilities with any degree of certainty. AM Best is continually increasing its estimate of ultimate industry asbestos losses. In 2009 the ultimate estimated increased approximately $10 billion from $65 billion to $75 billion. At year-end 2012, AM Best increased its estimate to $85 billion and believes the industry to be inadequately reserved by $10 billion. Yet, the proposed measurement objective allows for no consideration of uncertainty and encourages booking less adequate reserves.

The impetus for the evolution of insurance regulation during the nineteenth and twentieth centuries was primarily solvency concerns as insurance entities repeatedly demonstrated a willingness to compete to the point of insolvency. The industry has a legitimate interest in the solvency of all market participants as insurance insolvencies are spread through all participants via guaranty fund assessments. Certainly solvency and financial stability are important to insurance consumers, both individuals and businesses, who seek the assurance given by reputable companies that their claims will be paid. For these reasons, solvency is a concern for investors as well. Without confidence in the insurance market, no market would exist.

It would be deeply regrettable to sever the ability of insured entities to carry the same nominal reserves on a statutory and GAAP basis. Users depend upon both GAAP and statutory statements and disclosures to optimize all available information. Although appropriate accounting items are treated differently due to the differing objectives of the two standards, having the carried nominal liability in agreement creates a harmony that is beneficial to both users and preparers and provides useful information on company operations and objectives. Divorcing the liability measure between these standards will increase auditing work, disclosures, and reconciliations (if possible) and create a loss of confidence on the part of users. Many financial statement users rely on statutory statements and disclosures to track loss development and estimate reserve adequacy. Breaking the link between GAAP and statutory accounting could very possibly lead to ascendency of statutory statements as the preferred source of information by statement users.

It would also appear that mandating a specific liability measurement objective ignores consideration of enterprise risk management (ERM), usurps the role of insurance regulators, and abandons the role of free market discipline. While it is well within FASB's role to set accounting standards, the proposed guidance infringes upon what should be a prudent risk management decision. Evolving ERM practices may place the optimal enterprise liability measure at some other point than the "statistical mean". If the thought in writing the guidance was that entities may carry reserves below the "statistical mean", that concern is within the province of insurance regulators, who carefully monitor reserve adequacy and will act, if necessary. Likewise, free market forces will reward or punish entities which consistently carry reserves that are too low, too high, or too variable. If the purpose of a financial statement is to provide information on company operations, then so be it. Regulators and free market forces will act to ensure proper measurement of liabilities.

BC346c states that "The Board was not persuaded that the business model should drive the liability measurement…" It is equally true that the accounting standard should not dictate business model. Yet the proposed standard will do just that. Mutual companies, owned by their policyholders, traditionally carry higher levels of reserves than their pure stock counterparts. Also, mutual companies are generally far more concerned with overall reserve adequacy than the precise allocation of bulk reserves to incurred period (accident year) and, as a result, are not overly concerned with estimating expected cash flows. While investment income is important, these companies clearly are not "playing the float" in the manner of the suggested by BC346c. Yet, many mutual companies participate successfully in capital markets through ownership of a downstream stock company. Contrary to the conclusion in BC346c, discounting does not align with these insurers' business models.

Preparers: Complexity and Cost

From an actuarial perspective, the first and foremost concern related to the liability measurement changes contained in the proposed standard is the paradigm shift in the determination of the incurred loss liability from current relativity simple concept of establishing a reserve as the difference between an estimated ultimate loss and the claims amount paid to date, to the much more complex concept of fulfillment cash flows. While some aspects of current methods and models currently exist which could aid in this transition, actuaries, accountants and insurance entities will likely have a tremendous amount of work to do overhauling old systems or creating new systems, reports, spreadsheets and procedures in order to calculate a liability on a cash flow basis. Calculating an expected cash flow pattern will require collecting and aggregating many data elements that may not be readily available and which are currently not used by management.

Aside from cash flows, the determination of a yield curve for liabilities will have to be made. This is not common practice in the P&C industry and few have any experience or expertise applying this concept. Moreover, once such a determination is made, initial portfolio yield curves will have to be retained (for "other comprehensive income" calculations) and new curves created each reporting period. Combined with continuously updating the expected cash flow/loss payout pattern each reporting period, and maintaining the patterns used in historic periods, the number of variables to track and update will be exponentially increased over what is required for the current accounting standard.

Additionally, portfolios will have to be defined and created, and all manner of reports aggregating cash flows by portfolio will need to be programmed. Smaller insurance entities may find portfolio construction daunting given some of the restrictions presented and may end up with portfolios that do not have credible data with which to estimate an expected cash flow. In these situations, a means by which to use supplementary information to produce an expected cash flow (like industry data) may need to be found. Portfolios may require periodic testing to ensure they still meet the duration/release from risk definition, which will require more testing and control procedures than currently needed.

With regard to the liability for remaining coverage, it is probably fair to say that nearly all primary P&C entities financial systems are currently set up to simply recognize earned premium uniformly over the policy period. Primary writers will need to reprogram systems for lines of business where expected incurred losses are not uniformly distributed over the policy period (and those lines of businesses must first be identified). Reinsurers could face an even more daunting task in determining an appropriate earnings pattern as excess property covers are certainly prone to seasonal variation. Complicating the calculation for assumed reinsurers is the need to determine the how non-uniform earnings patterns may need to be applied to "earned but not reported" (EBNR) premium, a concept which is sometimes used to calculate earned premium on proportional reinsurance contracts. A means by which to apply the "Onerous Contract Test" to individual portfolios will have to be created. For many entities, this last item will likely be very difficult to perform with any degree of precision if required to estimate losses for a pending natural (or manmade) catastrophe at the close of a reporting period.

Other Issues and Recommendations

This and the following paragraphs offer observations on issues not specifically addressed in the preceding discussion. The items addressed are not trivial, and the recommendations for improvement should by no means be construed to be an endorsement of the proposed guidance.

Surety Bonds: Mandate All as Subject to PAA and Remove Discounting of Liability for Remaining Coverage

The proposed guidance introduces unnecessary complexity concerning the measurement of surety bond liabilities. Section 834-10-55-53 emphasizes a surety bond should be accounted for using the Premium Allocation Approach (PAA) as long as (1) the contractor's financial position is stable, and (2) the contractor has historically completed construction projects on time. The guidance implies that if these conditions are not met, the Building Block Approach (BBA) should apply. Most P&C entities write a number of lines of P&C business, including surety bonds. The vast majority of P&C lines of business, if not all, would be subject to the PAA. It would be inefficient and not cost effective to create and maintain accounting systems and procedures to deal with a subset of contracts for one line of business in the event that the stated conditions to quality for the PAA are not met. It would be far better just to state that surety bonds are always subject to the PAA.

Also concerning surety bonds, section 834-10-55-131 sets conditions under which the liability for remaining coverage must be discounted. In this section, discounting is required if all premium is received at inception for a multiyear bond. There is a type of surety bond called a "probate" bond issued to assure the performance of an executor in the distribution of property and assets in accordance with a deceased's will. The contract can cover multiple years, especially if there is a minor and guardianship involved. These bonds are legally non-cancellable for nonpayment of premium. In order to ensure full payment of premium, issuers normally collect all premium up front and do not risk nonpayment by allowing periodic billing, as would be suggested in 834-10-55-131(a). In this case we are again dealing with a subset of contracts within the surety bond line of business. Most P&C lines of business will not be required to discount the liability for remaining coverage. In order to promote efficiency of systems, procedures and uniform application of the accounting standard, it would be beneficial to exempt all surety bonds from the requirement to discount the liability for remaining coverage for the time value of money.

Liability for Remaining Coverage: Eliminate Requirement to Follow Incurred Claims Recognition Pattern

The proposed guidance in Section 834-10-34-27 explicitly states that revenue recognition from the liability for remaining coverage be based "… on the expected timing of incurred claims and benefits if that pattern differs significantly from the passage of time." As noted in BC336, this is consistent with current GAAP, although the guidance in 944-605-25-1 is not quite so explicit. Presumably this is an attempt to match premium earnings with claims activity for P&C lines of businesses which exhibit seasonal variability, which are mostly property lines.

The prevailing and easiest practice in the P&C industry is to recognize earnings uniformly over the contract period. Systems and accounting producers have long been in place to calculate revenue in this manner. Explicitly requiring a variable recognition pattern adds needless complexity and does not provide materially meaningful information to users as the entire contract premium is earned within one year. Additionally, the liability for incurred claims for the affected (mostly property) lines of business are already exempt from discounting as the claims settlement period is less than one year. It is likely that attempting to mandate variable earnings periods will result in more diversity of practice, not less. This requirement to use earnings patterns based on the expected timing of incurred claims should be deleted from the guidance as it provides little material information to the user and presents preparers with additional calculation hurdles in order to complete financial statements.

Onerous Contract Test: Require Recognition if the Loss can be Reasonably Estimated

Proposed guidance section 834-10-25-12 requires the recognition of a liability associated with a portfolio of Onerous Contracts during the pre-coverage period and defines the liability as the excess of the expected present value of cash outflows over the expected present value of cash inflows. No guidance is given on how an entity is to calculate or estimate the expected value of cash outflows for an event that has not occurred. While the Onerous Contract concept is sound, in many situations P&C insurance companies would have great difficulty in producing an estimate with any degree of precision. The requirement to do so will likely result estimates that range from pure guesses to sophisticated modeling projections and a wide diversity in practice. The impact of reinsurance recoveries and possible reinstatement premiums would presumably have to be considered, complicating the calculation. Such estimates would create difficulties in attempting to compare performance between entities, and could distort year to year comparisons of performance over various reporting periods. Current guidance for the Premium Deficiency Reserve in 944-60-25-1 states that "the loss must be reasonably estimated." It would seem that a reasonably estimated loss would be valuable information for a financial statement user. If the loss cannot be reasonably estimated as of the reporting date, it is probably more helpful to not set an Onerous Contract Liability, but disclose the reasonable loss estimates, if available, in the notes as a nonadjusting subsequent event.

Onerous Contract Test: Allow Recognition of Anticipated Investment Income

The proposed guidance in 834-10-25-12 does not allow for the recognition of anticipated investment income when testing for or calculating an Onerous Contract Liability, which is allowed under current guidance. In BC341 it is stated that "The Board noted that the requirement to include discounted cash flows may offset the entity's inability to include expected investment income in performing the onerous test and that, therefore, the change to existing U.S. GAAP would be immaterial." This is not true. The P&C coverages likely to impacted are property lines of business which are exempt from discounting as the claims settlement period is less than one year.

Final Comments

Users of financial statements which report short-duration contracts will lose much more valuable information than will be gained if the current standard is abandoned in favor of the proposed guidance. The exercise of discounting presents the façade of precision and meticulous application of economic theory while the result provides no information about cash flow uncertainty and creates artificial volatility in the earnings measurement. The P&C industry will lose a time tested accounting system in exchange for complexity and uncertainty which may hamper its ability to attract and retain capital and increase solvency risks. Preparers will face daunting compliance challenges, increased costs, and the likelihood of having to supply sufficient disclosure to reproduce the original undiscounted liability by reporting period. Statutory statements may take prime ascendency as the preferred information source for publicly held P&C insurance companies.

Judging by the comment letter responses to FASB's agenda proposal and discussion paper, I believe it is fair to presume that the majority of US P&C insurance entities would prefer to retain the current standard for short-duration contracts. Responses I have heard from P&C stock analysts concur. In fact, during the time I spent assimilating, examining and evaluating the proposed guidance, I had the opportunity to hear, speak and interact with several professionals from various P&C insurance companies, trade organizations, stock analysts and insurance regulators. Some were strictly users of financial statements and others were strictly preparers. *Not one* would voice the opinion that the proposed guidance is an improvement over the current standard for short-duration contracts. I am aware of several P&C organizations which are preparing comment letters. In each case, there are recommendations to make the proposed guidance more acceptable by exempting short-duration contracts from discounting and amending the unbiased probably-weighted measurement objective to enable the reflection of uncertainty. Whether stated explicitly or implicitly, all of these organizations would simply prefer the Board to exempt the applicability of the proposed guidance to short-duration contracts. The Board should keep this thought in mind when reading proposals which are basically attempts to make the proposed guidance very similar to the current standard.

FASB has no apologies to make in regard to the current standard for short-duration contracts. In fact, FASB has every reason to hold its head high and take pride in having produced a durable standard and which has served users, preparers and regulators extremely well over a long period of time. To even consider abandoning such fine work, any alternative would have to proven beyond doubt to be very much superior. I do not believe the proposed guidance is in this category.

I must ask you again to be courageous enough to not let the momentum of this project displace the clarity, comparability, simplicity and elegance of the current standard for short-duration contracts which has been vetted through numerous economic cycles, is well accepted by preparers and users alike, and serves as a harmonious complement to the regulatory needs of statutory accounting. Convergence on an international accounting standard for insurance contracts is a laudable goal; however, the proposed standard for short-duration contracts is deficient and certainly not an improvement on the current guidance.

Sincerely,

Kelvin Sederburg
ACAS, MAAA
Enc.

Questions for Respondents: FASB Exposure Draft "Insurance Contracts (Topic 834)

Questions for All Respondents

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

I do not agree with the scope of this standard. Issuers of short-duration contracts should be exempted from application as the proposed guidance is far inferior to current guidance.

Recognition
Questions for All Respondents

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

No Comment.

Initial and Subsequent Measurement
Questions for Users

Question 3: Will the proposed measurement model produce relevant information that will help users of an entity's financial statements make economic decisions? If not, what changes do you recommend and why?

The proposed measurement model will provide users will less relevant information than the current guidance for short-duration contracts. Specifically, the requirement to discount "uncertain" cash flows and the requirement to aggregate contracts by "portfolios" rather than management's business segmentation will seriously erode useful information, such as the "true" actual liabilities carried by an entity and the reasonableness/adequacy of that "nominal" amount, and provides no useful and differentiating information about the operational integrity of the entity. Comparability between entities will be rendered futile as differing portfolios, payout pattern assumptions, discount rate assumptions and a plethora of other subjective "assumptions" will submerge useful information. Further, comparability to the wealth of information available under the current short-duration contract accounting standard, which has served well over time and through various economic and insurance cycles, will be lost. An accounting standard should be an accounting standard. An accounting standard should not attempt to masquerade as an economic capital model. Recommended Change: Retain the current guidance for short-duration contracts.

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

The aspect which will most significantly "decrease" information that can be used in making economic decisions concerning short-duration contracts is the requirement to discount "uncertain" cash flows for the time value of money. The Board needs to understand the significant variability underlying payout patterns for short-duration contracts. Discounting is useful when payout patterns are certain. However, discounting payout patterns which can vary significantly produces liability estimates which are more uncertain and less useful than working with nominal figures.

Most users far prefer to obtain nominal information and apply their own discounting assumptions. It is likely that users will demand enough disclosures to reproduce nominal figures, to which the user's discounting assumptions can be applied. Further, comparability between entities will be reduced as differing discounting assumptions (i.e. payout patterns, discount rates, etc) will be selected.

Recommendation: Remove the requirement to discount cash flows under the premium allocation approach.
Better Recommendation: Retain the current guidance for short-duration contracts.

Measurement Approaches

Questions for All Respondents

Question 5: Do you agree that entities should apply different approaches to contracts with different characteristics, described as the building block approach and the premium allocation approach? If not, which model do you think should apply and do you think there should be any changes made to that model?

I agree that different approaches should apply to contracts with different characteristics. The preferred approach for short-duration contracts is that contained in current GAAP guidance, NOT the premium allocation approach or the building block approach.

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

I do not agree. For short-duration contracts, current GAAP guidance should be retained. The proposed premium allocation approach and the building block approach should not be made applicable to short duration contracts.

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

I do not agree. For short-duration contracts, current GAAP guidance should be retained. The proposed premium allocation approach and the building block approach should not be made applicable to short duration contracts.

Portfolio and Contract Boundary

Questions for Preparers and Auditors

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

The definition of a portfolio of insurance contracts and the application of the proposed guidance to apply this concept does not work for entities which traditionally use calendar-accident year reporting, specifically, short-duration property/casualty contracts. Calendar-accident year aggregations do not match premiums and losses from the exact same contracts. The guidance's application appears to imply an entity would work with a portfolio of "claims" and not a portfolio of "contracts". Further, requiring entities to aggregate by portfolio provides users with inferior information to allowing entities to report by the way the contracts are managed and how management aggregates for measurement.

Recommendation: Retain the current reporting guidance segmenting business by the way in which it is managed and measured.

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

The concept of a contract boundary is not an issue. For short-duration contracts, the entire concept of attempting to estimate the timing of uncertain cash flows for the purposes of discounting should be abandoned as it significantly erodes decision useful information.

Fulfillment Cash Flows

Questions for Preparers and Auditors

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

Concerning short-duration contracts, the entire concept of attempting to estimate the timing of uncertain cash flows for the purposes of discounting should be abandoned as it significantly erodes decision useful information.

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

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

Recommendation: Retain the current guidance for short-duration contracts.

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

In regard to the premium allocation approach, as an actuary, I cannot agree to this proposal. To target an unbiased mean without any explicit or implicit conservatism is not good actuarial, business or regulatory practice. Many actuaries consider the statistical mean, if one could accurately identify it, to be the very lowest reasonable reserve an entity should consider booking. According to AM Bests 2004 historic study, inadequate reserves are the leading cause of insurer insolvencies. Targeting the lowest reasonable point increases the risk of insolvency and is completely at odds with statutory accounting guidance. Insurance entities are subject to an intense regulatory regime. State auditors and AM Best generally prefer carried reserves to be "conservative" in line with the explicitly stated goal of statutory accounting. Requiring an "unbiased, probability-weighted mean" severs the remaining link between GAAP and statutory accounting, a step most insurance entities do not want to take.

Recommendation: Retain the current guidance for short-duration contracts.

Questions for All Respondents

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

Estimating cash flow patterns should be abandoned in favor of retaining the current GAAP guidance for short-duration contracts. Applying discounting to "uncertain" cash flows erodes decision useful information and produces more uncertain estimates of ultimate liability.

Discount Rates and Discounting

Questions for All Respondents

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

I would agree that discount rates should not be used at all for short-duration contracts as their application erodes the decision useful information contained in the booked nominal liabilities.

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

For contracts measured using the premium allocation approach, discounting should not be required. Discounting cash flows for which the timing is certain is useful. Discounting the very uncertain and variable cash flows underlying short-duration property/casualty contracts provides less than useful information. I would recommend that the current GAAP guidance for short-duration contracts be retained, and that the short-duration contracts be exempted from the proposed guidance.

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

Discounting should not be required for short-duration contracts. Discounting the very uncertain and variable cash flows underlying short-duration property/casualty contracts erodes decision useful information. It is recommended that current GAAP guidance for short-duration contracts be retained.

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

No Comment.

Questions for Preparers and Auditors

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

The whole concept of discounting should not apply to short-duration contracts because the variability in cash flows will result in more uncertain estimates of liability and provides less decision useful information to users than current GAAP guidance for short duration contracts. However, one action which would slightly improve comparability under the proposed approach to all contracts would be to allow for a practical expedient to determine the discount rate, such as that used for an A or AA bond. However, whether prescribed or determined per the proposed guidance, it is ambiguous what the discount rate really represents. It is very likely not the rate that would be used to value an entity. It is fairly meaningless as there is no liquid market for short-duration contract liabilities. It would appear to be discounting for the sake of discounting, and not because there is any particular meaning to the resulting discounted value.

Question 19: Do you agree that interest expense generally should be based on the discount rates determined at the date the portfolio of contracts was initially recognized? Why or why not? If not, what do you recommend?

Discounting should not apply to short-duration contracts because the variability in cash flows will result in more uncertain estimates of liability and erodes decision useful information. Current GAAP guidance on short-duration contracts provides superior information and should be retained. If not for the ambiguity surrounding the definition of a portfolio (i.e. can a portfolio remain open forever?), an actuary would answer that the most appropriate date would be the average date of loss. However, in order to provide maximum applicability, using the portfolio inception date is fine (assuming discounting provides useful information, which it does not for the uncertain cash flows of short-duration contracts).

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

No comment.

Margin for Contracts Measured Using the Building Block Approach

Questions for All Respondents

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

No comment.

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

No comment.

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

No comment.

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

No comment.

Questions for Preparers and Auditors

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

No comment.

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

No comment.

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

No comment.

Acquisition Costs

Questions for Preparers and Auditors

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

No comment.

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

No comment.

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

No comment.

Insurance Contract Revenue

Questions for All Respondents

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

Yes. The current short-duration contract guidance provides an excellent exhibition of income performance and should be retained. The presentation in the proposed standard should be rejected.

Question 32: Do you agree that, for all contracts, revenue should exclude any amounts received that an entity is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs and that expenses should exclude the corresponding repayment of those amounts? If not, what do you recommend? Please specify whether your view depends on the type of contract.

No. This would be a change from current GAAP guidance for short-duration contracts that would cause unnecessary complications.

Best Recommendation: Retain the current accounting guidance for short-duration contracts.

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

I agree only with the practical expedient. I do not agree with the concept of discounting short-duration contracts because the variability of cash flows renders the user information close to meaningless. I would recommend retaining the current guidance in totality for short-duration contracts.

Questions for Preparers and Auditors

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

No comment.

Participating Contracts

Questions for Preparers and Auditors

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

No comment.

Reinsurance

Questions for All Respondents

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

No comment.

Questions for Preparers and Auditors

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

Cedants of short-duration contracts should be allowed to continue to apply the current GAAP accounting standards for short-duration contracts as the proposed guidance decreases decision usefulness about the both the cedants' gross and net liabilities.

Insurance Contracts Acquired in a Business Combination

Questions for All Respondents

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

No comment.

Contract Modifications

Questions for Preparers and Auditors

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

No comment.

Presentation

Questions for All Respondents

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

It is recommended that the current presentation be retained for short-duration contracts as well as all current guidance as this provides superior decision useful information compared to the proposed presentation/guidance. Specifically, neither the premium allocation approach nor the building block approach is superior because of the requirement to discount "uncertain" cash flows, that is, cash flow for which both the timing and amounts are significantly variable. The current guidance for short-duration contracts is well understood by users and preparers and has been time tested through numerous economic and insurance cycles. The proposed guidance and presentation will destroy all comparability to a wealth of historic earnings information accumulated under a well understood accounting regime. The bottom line is that the proposed guidance for short-duration contracts is not an improvement over current standards and will likely drive investment capital away from the insurance sector.

Disclosure

Questions for All Respondents

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

The objective of the disclosure requirements is to enable users of the financial statements to understand the amount, timing, and uncertainty of future cash flows arising from insurance contracts. In regard to short-duration contracts, the proposed guidance itself does not accomplish this objective. The proposed onerous disclosure requirements are proof that the guidance is so complex as to attempt to provide users with enough useful information to return liability estimates to understandable nominal (that is, undiscounted) values. It would be far better to retain the current GAAP guidance for short-duration contracts and perhaps require a few additional disclosures, such as what is the entity's best estimate of the uncertain loss payout pattern, to allow users to perform their own discounting exercise with their own assumptions and aggregations (which is users current practice). In effect, the proposed guidance for short-duration contracts and the proposed disclosures provide less decision useful information to users than does the current GAAP guidance for short-duration contracts.

Effective Date and Transition

Questions for Preparers and Auditors

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

Issuers of short-duration contracts currently do not have systems in place to perform discounting on the scale required by the proposed guidance, nor do many issuers have the expertise to determine appropriate yield curves for the various portfolios. The requirement to discount short-duration contracts is the largest single driver that will affect the timing of implementation as well as the implementation and ongoing expense associated with the proposed standard. The reason for this is simply because issuers of short-duration contracts do not approach business operations in this manner. It is true that investment income is important to issuers of short-duration contracts, but few perform discounted cash flow exercises as the contract time horizon is limited. It would not be wise to compare the ordinary property/casualty company to a multinational conglomerate which "plays the float".

As an actuary, I can tell you that the loss reserving process itself will have to be changed very significantly from determining an ultimate nominal loss and implied reserve to be booked to a much more complex cash flow reserving approach. Many entities are not now set up to perform this complex exercise. Many entities will need to hire and train more actuaries, or hire consultants, in order to comply with the proposed guidance. Even for a company that has credentialed actuaries, the reserving process itself, in many cases, will have to be overhauled so radically that several reporting periods, or years, would be needed to fully test and vet the new processes. Further, portfolios will have to be defined, aggregated and tested. Systems and procedures to do so will need to be developed. Extensive Sarbanes-Oxley compliance procedures will need to be developed. More accounting resources would have to be acquired and personnel trained. Very extensive rewrites explaining procedures (once they are created) and processes would have to take place to satisfy disclosure requirements.

In total, it will take several years for most entities to be in a position to implement the proposed guidance. It would not be unreasonable to have a five year transition period.

On the other hand, the current GAAP guidance for short-duration contracts is quite excellent and well understood by users and prepares. If a few additional disclosures or adjustments were required to make the current standard even better, the implementation time and costs would be fairly minimal.

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

If this guidance were to be adopted, which it should not, it would be wise to select an implementation date far enough into the future so that all impacted entities would be properly prepared and in a position to comply.

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

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

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

No comment.

Questions for Users and Auditors

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

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

Costs and Complexities

Questions for Preparers

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

For issuers of short duration contracts, the requirement to discount cash flows is the single item which will incur the most cost and provide the least benefit. Issuers of short-duration contracts currently do not have systems in place to perform discounting on the scale required by the proposed guidance, nor do many issuers have the expertise to determine appropriate yield curves for the various portfolios. More actuaries will have to be hired or consultants engaged because, for many entities, the reserving process itself will require a complete overhaul. Currently, reserving processes focus on determining the ultimate nominal loss and, from that, the appropriate loss reserve to book. In other words, the focus is on the ultimate loss and not the timing or amounts of incremental losses. Processes will need to be changed to shift to a cash flow approach. The need for talent to perform such calculations will be not only an initial, but an ongoing and expensive cost consideration. More accounting investment relation will be required to track the many new variables introduced and explain the complex drivers of financial results to users.

More accounting resources will be required on an ongoing basis to apply the proposed guidance. More investment relation resources will be required to explain to users the drivers of financial results obscured by the complex accounting procedures. More information technology resources will be required to set up and monitor the many new processes and track the many new variables required by the proposed guidance.

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

Questions for Auditors

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

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

However, this expense can be avoided if short-duration contracts were exempted from the proposed guidance and the excellent current GAAP standard for short-duration contracts, which is well understood by preparers, auditors and users, is retained.