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Technical Director
File Reference No. 2013-290
Financial Accounting Standards Board
P.O. Box 5116 401
Merritt 7
Norwalk, CT 06856-5116
Via e-mail @ director@fasb.org

Re: Proposed Accounting Standards Update: Insurance Contracts (Subtopic 834)

Dear Technical Director:

The Hartford Financial Services Group Inc. (“The Hartford” or “we”) appreciates the opportunity to comment on the Financial Accounting Standards Board’s Proposed Accounting Standards Update (“ASU”) concerning *Insurance Contracts (Subtopic 834)*. The Hartford is currently focusing on its property and casualty and group benefits businesses, and is among the largest providers of property and casualty and group benefits insurance products to both individual and business customers in the United States. The Hartford also continues to manage life and annuity products previously sold. The Hartford holds \$258 billion of insurance-related liabilities and will be impacted by the final guidance resulting from this proposed ASU.

We believe the proposed ASU represents an improvement over the FASB’s 2010 Discussion Paper, *Preliminary Views on Insurance Contracts*. However, we believe the proposed ASU’s accounting and reporting results in complexities which will yield financial statements and disclosures that will be less useful and reliable to users compared to current U.S. GAAP. We also believe certain provisions of the proposed ASU are unclear and will be difficult to apply, and will not improve comparability among insurers that offer similar products.

The Hartford offers the following summary of our observations, some of which are further discussed under the relevant questions from the proposed ASU in the attached appendix:

- For short-duration insurance contracts, we do not believe the proposed ASU represents an improvement over current U.S. GAAP, primarily because of the proposed ASU’s discounting requirements and the related complexities introduced into the financial statements and disclosures as a result of such discounting. We believe that discounting is appropriate for certain short-duration contract liabilities with long tail claim settlements that have payment patterns and ultimate costs which are fixed and determinable. However, discounting other cash flows for short-duration contracts adds undue complexity and additional subjectivity to an already imprecise reserve estimate.

- Furthermore, for short-duration insurance contracts, we do not believe it is appropriate to discount reserves without including a risk margin. Without the risk margin, we believe that the use of the premium allocation approach will result in a front-ending of profits, which we do not believe to be a representationally faithful result given the nature of property-casualty reserves. Accordingly, we believe the recognition of profit over the contract term under the premium allocation approach combined with the discounting requirement is imprudent. Property-casualty insurance reserve estimates can change over time because of unexpected changes in the external environment, and are subject to reserve uncertainty stemming from a number of conditions. We do not believe such results provide better decision-useful information to users, and believe current U.S. GAAP provides simpler and therefore more meaningful and useful information to analysts and investors.
- We believe that the proposed ASU's onerous contract requirement to accrue losses for a catastrophe prior to the occurrence of the obligating event will result in misleading information that users will be forced to either ignore or adjust in order to better understand an insurer's results and reserve adequacy. We believe the loss recognition model for onerous contracts should be consistent with the loss recognition concepts of the proposed ASU's fulfillment cash flows.
- We find the revenue presentation and metrics of the building blocks approach confusing, overly complex and burdensome to prepare, maintain and explain. We agree that revenue and expense metrics are more decision-useful than a summarized margin and commend the Board for changing its view from the 2010 *Preliminary Views on Insurance Contracts*. However, we believe reported revenue based on amounts paid by, or due from, the policyholder would be a more relevant metric.
- Regarding transition, we believe retrospective application should not be required for businesses disposed of through sale or 100% reinsurance. We do not believe that restating prior periods for businesses reported as discontinued operations will provide useful information to users. Furthermore, in cases where a business is sold or 100% reinsured, it would be extremely difficult, time-consuming and costly for preparers to restate prior periods, especially if the personnel and systems necessary to restate are no longer under the ownership or control of the preparer. We recommend that any business sold prior to the effective date be exempt from retrospective restatement. In addition, we believe ceding companies should be permitted to use assuming companies' measurements for businesses disposed of through 100% reinsurance and which the assuming insurer accounts for as a business acquisition or portfolio transfer.
- Contrary to the Board's intention, the transition provision that allows insurers to re-designate financial assets as if they newly adopted the classification and measurement guidance for financial instruments (the "Financial Instruments Proposed ASU") will not resolve our asset-liability mismatches that come about at adoption of the proposed ASU. Our financial assets would not be able to change among the "business model" designations contained in the Financial Instruments Proposed ASU. For example, we hold mortgage loans for collection and we could not say we hold them for collection and sale. Therefore the mortgage loans would still be under the 'held for collection' business model and be required to be at amortized cost even though they back insurance liabilities with changes in discount rates recognized in other comprehensive income, resulting in an asset-liability mismatch. Our preferred solution would be as

indicated in our comment letter on the Financial Instruments Proposed ASU - that all debt instruments should be classified as fair value with changes in other comprehensive income (“FV-OCI”) as the default and then an entity can conditionally elect amortized cost (for those debt instruments that will be held for collection) or unconditionally elect fair value with changes in net income (“FV-NI”). Failing our preferred solution, the proposed ASU should permit a more appropriate special provision – that financial assets backing insurance contracts should be permitted to be classified as FV-OCI or FV-NI if that classification would eliminate or reduce an accounting mismatch.

- If the Board were to issue a final standard consistent with the proposed ASU, the implementation of such a standard, at a minimum, will require significant investor education and analysis. In addition, significant time will be needed to educate management, the board and employees of the reporting entity. In addition, the retrospective application requirements of the proposed ASU will result in high costs requiring systems changes and accessing significant historical data. Therefore, we recommend a minimum transition period of at least three full years from the time a final standard is issued.
- We believe the proposed ASU is highly complex and, as a result, preparers will experience unforeseen implementation issues. Because of the complexities of the proposed ASU, we do not believe that all issues will be identified through limited field testing efforts that are currently underway or contemplated. Therefore, we recommend that the FASB form a working group that includes insurance industry experts to address such issues on a real-time basis during the transition period as well as ensure greater consistency in the application of a new insurance standard among preparers.
- Finally, as we stated in our November 2010 letter to the Board regarding the *Preliminary Views on Insurance Contracts*, we believe it is prudent to assess whether the SEC will require or permit U.S. public companies to transition their basis of reporting to IFRS prior to the FASB making a final decision on the proper course of action for accounting for insurance contracts. It would be a burden on U.S. insurance companies to implement significant changes to existing standards in the short run and then have to make wholesale changes to a new standard in a few years if the SEC chooses to transition to IFRS.

In the attached appendix, we provide responses to the proposed ASU’s Questions for Respondents.

Thank you for the opportunity to provide input on the proposal. Please contact me at 860-547-4848 or scott.lewis@thehartford.com if you would like to discuss our responses.

Sincerely,



Scott R. Lewis

Attachment - Appendix

Appendix Insurance Contracts – Questions for Respondents

Scope

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?

We have no objections to the scope and scope exceptions of the proposed ASU.

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?

We agree with the requirement to separate embedded derivatives from the host insurance contract.

With regard to the requirement to separate distinct performance obligations, we believe that the claim administration service included in our insurance contracts with policyholders are integral to the insurance contract. We interpret the language of 834-10-25-7 as helpful in the determination that such claim administrative service, when included in a contract that provides insurance coverage, is not a distinct performance obligation required to be separated from the insurance contract. Claim administration is an integral part of an insurance contract, and is not an optional service that a policyholder can choose when entering into an insurance contract. We also interpret that separate account investment management fees are integral to insurance contracts and would not be separated. However, we are concerned that example 2 of section 834-10-55-45 adds confusion and potentially contradicts the proposed guidance, as the example implies that claim administration services are distinct if such services are sold as a standalone service by other unrelated entities.

Regarding distinct performance obligations, we recommend that the requirements of paragraph 834-10-25-5 should be changed to require that both, rather than either, criteria be met in order for a performance obligation to be considered distinct. Specifically, paragraph 834-10-25-5 should specify that the policyholder or its beneficiary can benefit from the good or service either on its own or together with other readily available resources, *and* the entity's promise to transfer the good or service is separable from the promises associated with the insurance component of the contract.

We agree with the requirement to separate distinct investment components from the host insurance contract because we interpret that these would be few, if any.

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?

Because of our investment management activities as well as our interaction with institutional investment analysts, we offer the following comments from the perspective of a financial statement user.

For short-duration insurance contracts, we do not believe the proposed measurement model produces relevant information that will help users of an entity's financial statements make economic decisions because of the additional complexity introduced by discounting in the measurement model. We do not believe that discounted cash flows will be useful to users of the financial statements of property-casualty insurance companies, and, in fact, will be counter-productive for user analysis. For over three decades, users have relied on the financial statements of property-casualty insurers prepared in accordance with current GAAP and have reviewed undiscounted reserves for adequacy. Users' focus on reserve adequacy would not be served because the introduction of discounting without including a risk margin will increase the risk of reserve inadequacy. The use of discounting all cash flows will also introduce increased complexity for users because it will be significantly more difficult to understand claim reserve development. In addition, the introduction of the accretion of discount will add confusion to the analysis of insurers' profitability, especially due to the requirement to reflect the current discount rate in establishing reserves as of the end of any reporting period. We believe it is appropriate to discount only cash flows with fixed and determinable payment patterns.

We also do not agree with the example provided in paragraph 834-10-55-136 which would require an insurer to accrue a liability for a hurricane prior to the obligating event as part of the onerous contract test, for the following reasons:

- Accruing a projected liability for an approaching event, only to have to reverse it in the next reporting period, will mislead users and cause unnecessary volatility in the reporting entity's financial statements.
- We believe the loss recognition concepts of ASC 450 – *Contingencies*, should not be violated in an insurance accounting standard. The hurricane example of paragraph 834-10-55-136 violates ASC 450 because it is impossible to reliably estimate a loss before the actual occurrence of a catastrophic event even if the probability of that event is reasonably assured. For example, in the case of a hurricane, there is too much uncertainty in trying to predict when and where a hurricane will strike, what the magnitude of the hurricane will be when it hits landfall, and how severe damage will be to properties subject to coverage.
- We believe the loss recognition concepts for onerous contracts should be consistent with the concepts used for determining fulfillment cash flows. As stated in paragraph 834-10-

55-77, an entity should not take into account future events that occur after the reporting period.

We believe the hurricane example should either be removed or revised to make clear that approaching catastrophes that occur after the end of a reporting period should continue to be treated as nonrecognized subsequent events and disclosed consistent with Topic 855, *Subsequent Events*.

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

For short-duration insurance contracts, we do not believe that any aspects of the proposed measurement model significantly improve information that will be used in making economic decisions for either an insurer's management or investors. We believe current U.S. GAAP is well understood and acknowledged as relevant by users, and is consistent with how property-casualty insurers manage the business. We believe the proposed measurement model adds a significant level of complexity to the financial statements and disclosures and, as a result, will render the financial information less useful, reduce comparability among companies, and impair the effectiveness of metrics used to compare the performance of companies.

We believe the aspect of the proposed measurement model that creates the most complexity is the discounting, which will make reserve development analysis less clear. That complexity is compounded by the use of a multitude of issue year historical discount rate curves for the accretion through the income statement and one or more current discount rate curves for measurement of the reserves on the balance sheet.

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?

We agree that entities should apply different approaches to contracts with different characteristics. However, we are not convinced that the premium allocation approach represents an improvement over current U.S. GAAP accounting for short-duration insurance contracts. For short-duration insurance contracts, we believe current U.S. GAAP provides more meaningful and useful information to analysts and investors as reserves represent management's best estimate of the future payments to settle incurred claims, with discounting limited to fixed and determinable cash flows. Furthermore, the current revenue recognition model is well understood.

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?

While we believe the current accounting model for short-duration contracts is a better measurement model than the premium allocation approach, if the Board decides to issue a final standard consistent with the proposed ASU, we believe the premium allocation approach should be an election by the reporting entity and not a requirement for contracts that qualify for the premium allocation approach. Reporting entities with a significant number of portfolios/contracts that are required to be measured using the building blocks approach should be allowed, from a practical standpoint, to apply the building blocks approach to all portfolios/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?

We believe the proposed ASU guidance in 834-10-25-18, *Determination of the Model*, is less clear than the current ASC 944 guidance that distinguishes short-duration and long-duration insurance contracts. We believe the proposed ASU guidance is only clarified through the examples in the Implementation Guidance and Illustrations section of the Proposed ASU.

We believe the premium allocation approach should be an election by the reporting entity for contracts that qualify for the premium allocation approach. Reporting entities with a significant number of portfolios/contracts that are required to be measured using the building blocks approach should be allowed, from a practical standpoint, to apply the building blocks approach to all portfolios/contracts grouped together for management purposes.

We do not think that current short-duration insurance contracts would fail the proposed ASU's criterion for the premium allocation approach but we also have difficulty identifying why traditional whole life contracts would fail this criterion. For example, it is unclear whether changes in the discount rate are considered to cause significant variability in the assessment made at contract inception. We recommend the current definition of short-duration and long-duration be retained, perhaps with limited modification to rectify the circular use of the term "short-duration" in both the classification and definition of 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?

We believe the definition of portfolio is confusing and may lead to inconsistent application by preparers. We would recommend that it be made clear that different coverages within the same contract would not be considered separate portfolios (for example, auto physical damage coverage should not be considered a separate portfolio from auto liability coverage).

We also believe that a flaw exists in the proposed ASU regarding the use of portfolio as the unit of account for certain measurement applications in the building blocks approach and the premium allocation approach. We do not believe that the same level of disaggregation makes

sense for determining expected cash flows, discounting, onerous contract testing and margin. For example, expected cash flows and discounting may need to be determined at a product level by issue year. For onerous contract testing under the premium allocation approach, we suggest that contracts be grouped consistent with the enterprise's manner of acquiring, servicing, and measuring the profitability of its insurance contracts, which is the approach allowed today under ASC 944's premium deficiency test. We believe the current premium deficiency testing grouping is appropriate both from a practical standpoint and from the perspective that insurers often group coverages into one contract as part of an insurer's business strategy. An insurer's business strategy for certain contracts may be to sell one type of coverage at a loss to earn a profit on the overall customer account; disaggregating these contracts for purposes of the onerous contract test would not reflect the true economics of the business.

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?

We agree with the contract boundary requirements.

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?

Consistent with our response to Question 2, we believe that the claim administration services included in our insurance contracts with policyholders are integral to the insurance contract. We recommend that the proposed ASU clarify that when claim administrative services are sold as part of a policy that provides insurance coverage and qualifies for insurance accounting, the cash flows associated with the claim administration expenses shall be included in the fulfillment cash flows. We also extend that recommendation to separate account investment management fees and separate account fund level investment, administration, and expense fees.

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?

We agree that the assumptions used in the measurement of the fulfillment cash flows should be updated each reporting period.

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?

As indicated in our response to Question 5, we believe the current accounting for short-duration contracts should be continued instead of the premium allocation approach. That said, we believe the proposed ASU's guidance regarding fulfillment cash flows can be better clarified by including additional language from the related Basis of Conclusions paragraphs (BC131-134). The actuarial central estimate is not necessarily the statistical mean. However, we interpret the Basis of Conclusions language as saying that the "actuarial central estimate" and cash flows derived from multiple estimation methods is reasonably equivalent to the use of probability-weighted cash flows and it is not always necessary to develop explicit probability-weighted scenarios to meet the objective of determining the expected value or mean of the range of possible outcomes. Clarification to this effect should be brought into the guidance so that it will be part of the authoritative guidance. In essence, we are recommending that existing and long-standing actuarial estimation methods be clearly sanctioned because they meet the objective of an unbiased estimate of the mean.

In addition, if companies are required to discount the obligations under all short-duration insurance contracts and not just those that are fixed and determinable, the measurement value should include a risk margin above and beyond the actuarial central estimate. We recommend that this be accomplished through the use of management's best estimate in the determination of short-duration insurance liabilities, consistent with current U.S. GAAP. We believe that the determination of expected cash flows should consider outcomes not explicitly provided for in actuarial estimation methods. For example, we believe it is appropriate to allow for the consideration of additional sources of risk and uncertainty that affect ultimate claim payments, such as recent court decisions. Expected cash flows based on management's best estimate will provide for a level of prudent reserving, whereas the unbiased, statistical mean-based reserving under the proposed ASU may not fully capture information necessary in establishing adequate loss reserves for short-duration insurance contracts. Along with this recommendation, we also recommend disclosure of the difference between management's best estimate (i.e., recorded reserves) and the actuarial indication of reserves.

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?

We agree with this approach.

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?

Notwithstanding our cover letter comments concerning discounting of short-duration insurance contracts, we agree that the discount rates used by the entity should reflect the characteristics of the insurance contract liability and not those of the assets backing nonparticipating 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, we do not agree that expected cash flows determined using an unbiased, probability-weighted estimate should be discounted. We believe the discounting of all cash flows will increase the risk of reserve inadequacy and introduce increased complexity for users because it will be significantly more difficult to understand claim reserve development. In addition, the introduction of the accretion of discount will add confusion to the analysis of insurers' profitability, especially due to the requirement to reflect the current discount rate in establishing reserves as of the end of any reporting period. We also believe the proposed ASU's requirement to discount all cash flows will convey to users a level of measurement precision that does not exist. Therefore, for the measurement of short-duration insurance contracts, the only change we recommend to the current FASB Codification is to add the specific requirement to only discount cash flows with fixed and determinable payment patterns.

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.

While we do not agree it is appropriate to discount short-duration insurance contracts, we agree that if discounting were required, changes in the discount rate should be recognized in other comprehensive income rather than net income since the effect of changes in interest rates on the investment portfolio are also primarily included in other comprehensive income. However, this highlights the added complexity of discounting and, in our view, the benefits of discounting do not outweigh the added cost and complexity of the proposed accounting.

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?

We do not believe a test should be required to trigger recognition in net income of some or all of the amounts in accumulated other comprehensive income for changes in the discount rate. This test would be essentially a loss recognition test based on asset and liability mismatches. Such a test would be unwieldy and inappropriately require that a loss be recognized based on projections of asset-liability management practices that would be highly subjective. We believe that such a test would not provide useful information to users and would add additional complexity and confusion to the financial statements on top of the complexities already included in the reporting model in the proposed ASU.

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?

While we do not agree with discounting short-duration insurance contracts, if those contractual liabilities are discounted, we agree that the method for calculating the discount rates should not be prescribed.

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?

While we do not agree with discounting short-duration insurance contracts, when discounting is employed, we agree that interest expense should generally be based on the discount rates determined in the year the portfolio of contracts are initially recognized. Accretion of interest expense based on an inception discount rate will be less volatile and more easily understood than accretion based on a changing interest rate.

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?

We agree that interest accretion rates should be reset upon changes in expectations of the crediting rates used to measure the liability for insurance contracts with discretionary participation features. However, we believe the proposed ASU's approach using a level-yield basis over the remaining life of the contracts creates a measurement mismatch because it does not reflect the actual pattern of interest accretion on these contracts. Rather, we suggest the approach advocated by the American Council of Life Insurers ("ACLI") whereby the discount

rate would be set equal to a constant spread over or under the expected crediting rate when the cash flows are based on an expected crediting rate. Under the ACLI approach, the discount rate for any valuation follows the expected path of the credited rate over time plus or minus a constant spread.

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?

We agree that an insurer should not recognize a gain at initial recognition of an insurance contract, and we believe the single margin provides for a practical and easily understood mechanism for eliminating day one gains.

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.

We support using a one-margin approach as included in the proposed ASU. We believe the single margin provides for a more practical and easily understood mechanism for eliminating day one gains and providing a margin for adverse deviation over the life of the contract compared to the IASB's proposal. We believe that attempting to derive a separate explicit risk adjustment and contractual service margin would imply a false level of precision to both separate margin components.

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?

We do not support a separate risk adjustment and contractual service margin for reasons stated in our response to Question 22 above.

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?

We agree that a loss at initial recognition of a portfolio of insurance contracts should be recognized immediately in net income.

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?

We agree with the proposed ASU's method of recognizing margin.

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

We agree that interest should be accreted on the margin, but do not agree that such accretion should affect insurance contract revenue. We disagree with the proposed ASU's revenue presentation under the building blocks approach for reasons noted in our cover letter and in our response to Question 40 below.

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?

We do not agree that the margin under the building blocks approach should be subject to a continuing loss contract test. Administering the test would require tracking the profitability of contracts from inception to end, which would be burdensome. In addition, releasing profit when contracts are identified as loss contracts would be counterintuitive. The margin should be allowed to run off with release from risk regardless of whether contracts are profitable or not over their respective lives.

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?

We believe that the direct acquisition costs presented with the margin should include only direct selling or successful efforts acquisition costs as defined under existing GAAP. We believe the proposed ASU's guidance on qualifying acquisition costs is consistent with the types of costs eligible for deferral under ASU 2010-26, and that it would be burdensome and costly to change the definition of qualifying acquisition costs in the relatively short time period since the effective date of ASU 2010-26.

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?

If not expensed at contract inception, we do not object to reducing the liability for insurance contracts by the amount of acquisition costs, whether the liability represents the margin under the building blocks approach or the liability for remaining coverage under the premium allocation approach.

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

We agree with the proposed ASU's expense recognition requirements for acquisition costs. In addition, we believe the option to expense qualifying acquisition costs under the premium allocation approach for contracts with coverage periods of one year or less should be expanded to all contracts that qualify for the premium allocation approach. Expanding the ability to expense qualifying acquisition costs will allow preparers greater operational efficiency. In addition, for mature portfolios, we believe the results of expensing qualifying acquisition costs will not be materially different than deferring such costs for contracts that qualify for the premium allocation approach.

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. We believe that meaningful performance measures of both revenue and expenses are important and relevant to users of financial statements. Therefore, we agree that insurance contract revenue and expenses should be separately presented on the face of the income statement, rather than only changes in net profit. However, as noted in our cover letter and in our response to Question 40 below, we do not believe the proposed ASU's revenue recognition model under the building blocks approach will yield a meaningful or understandable performance measure.

With regard to short-duration insurance contracts, we believe that revenue should be recognized evenly over the coverage period consistent with the current guidance in ASC 944-605-25-1, rather than based on the expected timing of incurred claims and benefits. From an application standpoint, the passage of time approach is more practical considering that most short-duration insurance contracts have short-term coverage periods and it may be impossible to determine if the expected timing of incurred claims and benefits differs significantly from the passage of time. In addition, the incurrence of a claim does not reduce the insurance protection over the remaining coverage period. While there are some portfolios that may have seasonality attributed to losses, it is difficult to predict the timing of claim payments. Revenue recognition based on the expected timing of incurred claims would introduce added complexity to the preparation of

the financial statements and create additional distortion of performance metrics. Furthermore, we believe that explicitly stating that the revenue recognition pattern should reflect the expected timing of incurred claims may actually create diversity in its application and lack of comparability between insurers because some entities may believe they can estimate timing while others may not.

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.

We agree that revenue and expenses should exclude such amounts. However, we believe the guidance related to estimated returnable amounts needs additional clarification. Under a high deductible policy, losses within the deductible layer may be prefunded by the policyholder. We believe prefunded deductibles should not be considered insurance contract revenue because these amounts will either be paid by the insurer to a third party claimant if a claim under the deductible layer is incurred, or will be returned to the policyholder if a claim under the deductible layer is not incurred. Therefore, we recommend that the definition of “Estimated Returnable Amount” be amended to include third party claimants as follows: “The estimate of the component of an insurance contract that the entity is required to repay the policyholder, or pay to the beneficiary or a third party claimant that does not depend on whether an insured event occurs.”

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?

While we do not agree with the proposed ASU’s requirement to discount short-duration insurance contracts, if the Board chooses to require discounting, we believe the additional cost and complexity of discounting premium to be received beyond one year is unwarranted. For multi-year contracts with a significant financing component, such as the three-year surety contract example given in the guidance, we do not believe 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. Adjusting the liability for remaining coverage to reflect the time value of money creates a revenue and expense gross-up for imputed interest on premiums received up front; conceptually, premiums recognized in the income statement should ultimately reflect cash to be received at a nominal value.

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.

As noted in our cover letter and in our response to Question 40 below, we do not agree with the revenue presentation requirements under the building blocks approach. Notwithstanding our issues with the overall building blocks revenue model, we believe the proposed guidance on allocation between reporting periods is sufficient.

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?

We agree that participation features that are contractually dependent on the performance of other assets or liabilities of the insurer 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).

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?

We agree that a cedant should not record a gain at inception and that the excess of expected cash inflows over the ceded premium should be recognized as an asset at inception and expensed ratably over the coverage period.

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?

We agree that a cedant should estimate fulfillment cash flows as described above.

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?

We agree with the proposed ASU's guidance regarding insurance contracts acquired in a business combination.

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?

We agree with the proposed contract modification requirements described above.

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?

We do not agree with various aspects of the proposed ASU's statement of comprehensive income presentation. We believe that the following proposed presentation requirements, either

individually or in the aggregate, will render the statement of comprehensive income incomprehensible to users:

- *The requirement to present revenue under the building blocks approach as premiums excluding amounts attributable to estimated returnable amounts, plus the accretion of interest on margin and premium.* The revenue presented under the building block model appears to be complex and reverse-engineered. The layering of interest accretion into revenue will further confuse financial statement users. We believe the current revenue model for long-duration insurance contracts is easily understood by financial statement users, and would support efforts, such as the presentation approach suggested by the ACLI, to modify the proposed ASU's revenue presentation to a more easily understood and relevant performance measure. For example, we believe a more relevant and better understood performance metric for reported revenue would be one that reflects amounts paid by, or due from, the policyholder (albeit excluding amounts attributable to estimated returnable amounts, accretion of interest on margin and future premium amounts).
- *The requirement to report ceding commissions as a reduction of ceded premiums.* We believe the proposed ASU's reporting of ceding commissions will distort direct insurance revenue as well as certain underwriting ratios. As ceding commissions are intended to reimburse the ceding entity for costs it incurs in selling and underwriting direct contracts, we believe that ceding commissions should be reported as a reduction to other underwriting expense. While the category of other underwriting expenses does not exist within the illustrated income statement in the proposed ASU, we believe this line item is necessary in insurers' income statements. Furthermore, we believe it would be more appropriate to report ceding commission as an offset to the same line where direct acquisition costs will be expensed (under the option to expense such qualifying acquisition costs under the premium allocation approach).
- *The requirement to report separate account investment income and interest credited to policyholders on a gross basis.* We believe that the proposed ASU's requirement to present separate account pass-through activity will create a distortion of the income statement, and recommend that such amounts be presented on a net basis, consistent with the current, well-understood presentation. The pass-through activity does not inure to the insurer and may overshadow more relevant income statement amounts thereby confusing the reader.
- *The requirement to report ceded reinsurance amounts on the income statement.* We do not believe the proposed ASU's requirement to report ceded reinsurance premiums and claims/benefits on a gross basis in the statement of comprehensive income will necessarily provide meaningful information for financial statement users. We believe premiums and claims/benefits should be presented net of ceded amounts on the income statement with separate disclosure of direct, assumed and ceded amounts, similar to the current accounting under ASC 944 which allows for the effect of reinsurance on premiums earned and claim costs to be disclosed in the footnotes to the financial statements.

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?

We support the objective of disclosures to help users of the financial statements understand the amount, timing, and uncertainty of future cash flows arising from insurance contracts. We believe that such disclosures can be provided at an aggregate basis and still provide decision-useful information to users who understand the premium allocation and building blocks measurement and reporting models. However, the proposed disclosure requirements represent a significant increase to current requirements and will be challenging to complete in the limited time frame required by the SEC for public companies.

We support the reconciliations of opening and closing balances separately for contracts measured under the building blocks approach versus the premium allocation approach but only at the segment level. These reconciliations at a segment level will provide sufficient information to users of the financial statement without overburdening the document.

We support the disclosures of discount rates and expected cash flows in multiple time bands along with the weighted average discount rates used to determine the measurement of the expected fulfillment cash flows. However, we believe such disclosures should be reported at the segment level, consistent with how we operate and manage our businesses.

We believe the requirement to include correlations of risks may be overly complicated and difficult to judge against actual results. These sensitivities represent management's best estimates. To include these sensitivities in the audited footnotes to the financial statements may be misleading to the financial statement users and imply a practical ability for an insurer to accurately predict actual market movements and policyholder behavior changes.

We believe the paragraph 834-10-50-34 requirement to disclose market risk without prefacing the requirement to limit such disclosures to market risk arising from insurance contracts is not appropriate for an insurance accounting ASU. The disclosure, as written, may be construed as applying to investments.

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?

Key drivers include transition requirements and data availability as it pertains to businesses sold or 100% reinsured prior to the effective date. A final standard which requires restatement for such transactions will take longer to implement, as the reporting entity may not have the data needed to report those transactions.

Other key drivers include management, board and employee education, and investor outreach. The more complex the final standard, the more time we will need to implement. As we previously noted, the complexities introduced by discounting short-duration insurance contracts, unbundling certain components and the presentation issues noted above are, in our view, extensive and will require longer time to educate the preparer and user community.

Finally, we believe the overall complexity of the proposed ASU will affect the timing of implementation. Based on our experience with the implementation of ASU 2010-26 on accounting for acquisition costs, interpretations emerge during the implementation period, as preparers work through implementation issues with internal constituents and auditors. We also share nonproprietary implementation issues with our peer companies, as the industry tries to achieve a general level of consistency in the application of a new accounting standard. Given the issues involved in the implementation of ASU 2010-26, it took insurers a considerable amount of time, and more than inconsequential costs were incurred, to implement ASU 2010-26. The complexity of the proposed ASU dwarfs the complexities of ASU 2010-26, and we anticipate that the implementation issues and costs related to the proposed ASU will be significantly magnified.

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?

We have no comment on this question.

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?

Regarding practical expedients, we offer comments on the following transition issues:

1. *Businesses sold prior to the effective date of a new insurance accounting standard.* We do not believe the practical expedients relating to transition are sufficient for retrospective application because the practical expedients do not address businesses sold prior to the effective date of a new insurance accounting standard. For such business sale transactions, we see no benefit to users of restating prior period information using the proposed ASU's measurement models. This is especially true for businesses reported as discontinued operations. We do not believe that the application of the proposed ASU to discontinued operations prior to the effective date of a new standard provides investors, creditors, and others with information that is relevant in assessing the ongoing operations of an entity.

In addition, determining fulfillment cash flows and the appropriate discounting for prior periods will be cost prohibitive and impracticable because the reporting entity will a) no longer own the data and systems necessary to perform the retrospective measurements; and b) no longer employ the business experts, including actuaries familiar with the sold business, who have the expertise to perform the proposed ASU's measurements necessary for prior period restatement.

We recommend that any business sold prior to the effective date of a new standard be exempt from retrospective restatement.

2. *Businesses disposed of through 100% reinsurance transactions.* We also believe that a practical expedient is needed for businesses disposed of through 100% reinsurance, especially in situations in which the assuming reinsurer accounted for the assumed business as a business acquisition or portfolio transfer. In many of these transactions, it is customary for the assuming reinsurer to administer the business for the ceding entity, including the financial administration pertaining to the ceding entity's GAAP and statutory reporting requirements. Under the proposed ASU, the assuming entity's measurement basis for the 100% reinsured business may differ from the ceding entity's direct and ceded amounts under either the building blocks or premium allocation approaches, especially in situations in which the assuming reinsurer accounted for the assumed business as a business acquisition. For 100% reinsurance transactions consummated prior to the effective date of a new insurance accounting standard, we believe it will be impractical and cost-prohibitive to require an assuming reinsurer to measure the reinsured business under two different measurement bases in order to retrospectively restate prior periods because the assuming reinsurer will also be expending its resources on implementing a new insurance accounting standard for its own direct business.

Likewise, we believe it will also be impractical to require a ceding company to apply the building blocks or premium allocation measurement model to a business it has sold through reinsurance and no longer has the data, underlying systems or business experts necessary to effect such retrospective restatement.

For transition, we recommend that the ceding insurer measure its direct and ceded insurance based on the acquirer's/reinsurer's assumptions and measurements as of the effective date of the ceded reinsurance, and that the ceding insurer's direct and ceded accounts be exempted from the retroactive transition application rules for periods prior to the effective date of the ceded reinsurance.

The issue of retroactive restatement of prior periods for 100% reinsurance transactions and potentially other types of reinsurance transactions will add additional complexities to transition and the implementation of the proposed ASU's guidance. If the FASB does not agree with our proposal, we strongly encourage the FASB to develop additional practical expedients related to such transactions and we offer our assistance in such efforts.

3. *Redesignation of financial assets.* Although not a practical expedient, we bring up our concern with another special transition provision – the redesignation of financial assets. Section 834-10-65-1.1 of the proposed ASU provides that entities shall redesignate and reclassify financial assets relating to insurance contracts as if the entity adopted the classification and measurement guidance for financial instruments (the “Financial Instruments Proposed ASU”) on the transition date of the insurance contracts guidance. Simply said, this permits entities to re-do their adoption of the Financial Instruments Proposed ASU that may become effective before the insurance contracts proposed ASU, for those financial assets backing insurance contracts. In the Basis of Conclusions, the rationale was that if the insurance contracts accounting change results in an accounting mismatch, management may change its intent or business strategy with respect to the financial assets. The Board is mistaken in its belief that the transition provision that allows insurers to re-designate financial assets as if they newly adopted the Financial Instruments Proposed ASU will resolve asset-liability mismatches that come about at adoption of the proposed ASU. The Financial Instruments Proposed ASU requires the insurer to classify financial assets based on the business model which is:

- Amortized cost (“AC”) - if held to collect cash flows of principal and interest
- Fair value with changes in other comprehensive income (“FV-OCI”) – if held to collect cash flows of principal and interest and to sell
- Fair value with changes in net income (“FV-NI”) – assets not managed under the AC or FV-OCI business model.

Our financial assets would not be able to change among the business model designations contained in the Financial Instruments Proposed ASU.

Although it is difficult to recommend a solution in the midst of two proposed accounting standards, we are concerned with two particular circumstances and offer our recommendation regarding these. In one circumstance, we would like to designate mortgage loans that we hold for collection as FV-OCI to better match insurance liabilities at current value with interest rate changes reflected in OCI. In the second circumstance, we would like to designate debt investments that back modified coinsurance liabilities having embedded derivatives as FV-NI to better match the hybrid modified coinsurance liabilities that reflect all changes in the fair value of the debt investments in net income.

Our preferred solution would be as indicated in our comment letter on the Financial Instruments Proposed ASU - that all debt instruments should be classified as FV-OCI as the default and then an entity can conditionally elect AC (for those debt instruments that will be held for collection) or unconditionally elect FV-NI. Failing our preferred solution, the insurance contracts proposed ASU should permit a more appropriate special provision – that financial assets backing insurance contracts should be permitted to be classified as FV-OCI or FV-NI if that classification would eliminate or reduce an accounting mismatch. The special provision should not just be at transition but anytime an entity becomes newly involved with a new type of insurance contract.

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?

We have no comment on this issue.

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?

We agree with the proposed ASU's retrospective application requirements except for the issues regarding businesses sold and 100% reinsured prior to the effective date of a new insurance accounting standard, and the redesignation of financial assets, as described in our response to Question 44 above.

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.

Incremental costs associated with adopting the guidance of the proposed ASU include, at a minimum, the cost of systems changes including changes associated with older systems written in older programming languages, accessing significant historical data, and employee training, as well as significant investor education and analysis. As indicated above, in the case where a business has been sold or reinsured, some of the historical data needed may not exist. We believe the retrospective application guidance for transition is a key driver of these significant costs and that our recommendations stated in our responses to Questions 40 and 44 would alleviate some of these costs.

In addition, the overall complexity of the proposed ASU will drive up costs to adopt the guidance. In addition to incremental costs noted above, we anticipate costs related to consultants, auditors, and time spent with industry groups as preparers attempt to achieve reasonably consistent interpretations and application of the proposed new guidance.

We also believe significant ongoing costs will be incurred by preparers, including costs related to maintaining increased data and assumption support necessary to comply with the proposed measurement, reporting and disclosure guidance, and costs surrounding controls related to the increased data and reporting requirements. In particular, if the current approach used by property-casualty actuaries to arrive at an "actuarial central estimate" is not sufficient to represent an unbiased, probability-weighted estimate of cash flows, then there would be

significant costs in building stochastic models and other techniques necessary to arrive at a statistical mean.

In addition, current GAAP is closely aligned with our U.S. statutory accounting framework with regard to the accounting for short-duration insurance contracts. The proposed ASU would cause GAAP accounting to significantly depart from statutory accounting, resulting in additional costs related to maintaining separate sets of accounting systems.