



Property Casualty Insurers
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The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to comment on the FASB's Proposed Accounting Standards Update, **Insurance Contracts (Topic 834)**. PCI's more than 1,000 member insurance companies write over \$195 billion in annual premium, which represents 39 percent of the property casualty insurance coverage written in the United States.

Our comments are from the perspective of the property casualty insurance industry, whose business model and corresponding contracts are significantly different from those of life insurers. Differences between the accounting guidance for each of these separate business models are necessary for the effective and efficient financial reporting of their results.

Overall, we do not believe the guidance included in the proposed ASU related to reporting for short-duration non-life insurance contracts would provide more decision useful information than current U.S. GAAP reporting. The current accounting and reporting framework for P&C insurance contracts is well functioning, consistent with the business model of P&C insurers, and preferred by investors.

The U.S. GAAP accounting and reporting framework for P&C insurance contracts is currently applied throughout most of the world and has been operating very effectively for decades. The Exposure Draft (ED) would align the measurement of P&C incurred claims with the measurement of life insurance benefit reserves which we do not believe is appropriate. It would result in a loss of the usefulness of decades of historical performance data that represents the critical input investors use to project and analyze the performance of P&C insurers in a variety of economic and competitive environments over long periods of time.

Investors do not appear to support the ED. It is important to note that investors have historically supported the P&C insurance industry through participation in capital markets offerings during adverse business cycles and periods of major economic distress in large part because they understand our business and have access to financial reports that transparently reflect our financial results and condition. Because many traditional P&C investors do not support the ED on the basis that it will not produce financial reports that are transparent, understandable, comparable or consistent with the P&C insurance business model, we believe this could result in a reallocation of

investment funds within the financial services sector from P&C insurers to banks or other financial sectors with more transparent accounting. While the long-term impacts are unclear, in the short-term, traditional P&C investors may avoid the industry as it implements extensive accounting and reporting changes that they do not support. If this should occur, whether the investors would return and at what cost remains uncertain.

The ED would eliminate the historically valuable harmonization between the U.S. GAAP and U.S. Statutory accounting and reporting for P&C insurance. Currently, this detailed reserve development information is used by investors to support their evaluation of the ability of insurers in pricing business, setting reserves, and managing claims. The ED would eliminate this harmonization by requiring the U.S. GAAP measurement of reserves on a basis different from U.S. Statutory accounting which is the basis of reserves in both the Statutory Schedule P and 10k reserve development tables.

The ED would require the recognition and measurement of low-frequency, high-severity events before they occur on a probability basis with no recognition threshold for either the level of probability or the reasonableness of the loss estimate. This element of the ED represents a significant change for both the recognition of premium deficiency reserves under existing U.S. GAAP as well as the treatment of subsequent events.

The ED represents a principles-based proposal in a rules-based environment. While principles-based accounting works in some jurisdictions, it has typically not been effective in the U.S., which is also the largest P&C insurance market in the world. The lack of definitive guidance in key areas (e.g., the definition of a portfolio) of this complex proposal will produce inconsistencies that will later be addressed by the FASB, auditors, the SEC, PCAOB, or other regulatory authorities. The rules that will ultimately be imposed cannot be anticipated and could collectively fundamentally change the proposed standard, cause restatements, and generally create uncertainty around the P&C insurance accounting and reporting model which harms investors, insurers, and policyholders.

The ED would require substantial investments for educating and re-training finance staff, management, the board, investors, regulators, and other stakeholders. In addition, the ED would likely require substantial investments in technology to redesign and replace technology including general ledgers and policy administration systems currently utilized to develop financial reports.

We do not support the proposed guidance for P&C insurance in the ED. We believe current GAAP guidance for short- duration contracts, which is well functioning and clearly understood by preparers, auditors and users, should be maintained.

Questions:

I. Scope

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 agree that the guidance should apply to all insurance contracts regardless of whether they are written by an insurance enterprise. However, as indicated in our responses to the questions below, we do have significant concerns about the guidance related to non-life insurance contracts as currently drafted.

II. Recognition

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 do not agree that all distinct performance obligations should be reported separately. Property/casualty insurance contracts can include distinct performance obligations such as claims handling, risk management and loss control services all of which are applicable to the fulfillment of the contract. We believe it should be clearly indicated that these types of services should not be reported separately from the insurance contract.

III. 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?*

We do not believe the new guidance will provide more relevant information than what is currently being reported. The proposal is inconsistent with the current business model used by our members. The financial reporting should be driven by the business model being employed, not the other way around. The proposed reporting of discounted claims reserves in the financial statements will not be reflective of the claim reserve development information included in the Statutory Schedule P, making the analysis of claim development significantly more complex for the users of the financial statements.

We believe the proposal would significantly reduce, if not eliminate, the utility of historical data for the comparative work done by investment analysts, would add another uncertainty to the valuation of reserves through discounting and the requirement to use stochastic models for setting reserves; and would add significant complexity in analyzing P&C insurer results. The result being a more difficult environment for P&C insurers competing with other industries in the capital markets.

We believe current GAAP should be retained for P&C insurers.

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

We do not believe the proposal would provide improved information to the users of the financial statements. We believe the current model provides users better information to assess the amount, timing and variability of future returns.

IV. 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 life and P&C insurance are fundamentally different and should have different reporting models. However, while the Premium Allocation Approach is a more appropriate model than the Building Block Approach for property casualty contracts, we do not believe, as currently proposed, it provides more useful information to the users of the financial statements than the current model. The unearned premium reserve and undiscounted claim and claim expense reserves used in the current model are well understood and provide the users of the financial statements the base information they need for their analysis and comparisons of P&C insurers. The current model also facilitates comparisons and analysis between general purpose, regulatory and tax accounting reporting without adding significant complexity to the process.

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?*

We believe the accounting model to be used should be based on the characteristics of the insurance contract and that a bright line test of one year or less for the use of the premium allocation approach is not appropriate. We believe a contract should be reported using the model that best reflects its characteristics. A P&C contract which has the characteristics of a short duration contract but has a contract period of more than one year should not be required to use the building block approach.

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 agree with an approach that will provide for comparability, which is accomplished under current guidance.

V. Portfolio and Contract Boundary

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?*

There is concern that the proposed definition will reduce comparability by allowing significantly more subjectivity than current GAAP guidance in the construction of portfolios. There is also concern that the proposed qualifying language in 834-10-55-47 and 48 could create a problem for smaller insurers where the limitations on aggregating data may cause a reduction in the credibility of reserving data.

We believe the existing GAAP guidance related to portfolios is adequate and suggest it be maintained.

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 believe there could be an issue with the language in 834-10-25-14 which indicates that the contract boundary is at the point the insurer is no longer required to provide coverage or has the right or practical ability to reassess the risk of the policy or portfolio and can set the price or level of benefits to reflect that risk. Under state regulation, it is possible that a state may not allow an insurer to either raise the rates to reflect the risk of the contract or portfolio or to exit the market. The guidance should be clarified to maintain the contract boundary for reporting of these contracts on a consistent basis with similar contracts, not by state orders.

VI. Fulfillment Cash Flows

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?*

The issue of embedded options and guarantees is basically a life contract issue. However, regarding the question of the measurement of fulfillment cash flows, we do not agree with the use of stochastic models which have not been time tested and are not supported by P&C preparers, investors or regulators. We believe the existing incurred ultimate claim reserve estimates developed through the use of tested deterministic projection models continues to be most appropriate.

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?*

Yes, if material. However this does not include the discounting of reserves, which we do not support. We believe current GAAP guidance should be retained.

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?*

We do not support the required use of an explicit unbiased and probability weighted estimate of the future cash flows as the measurement of the liability for incurred claims. A statistical mean appears to be the very lowest reasonable reserve an entity should consider booking. Given that a leading cause of insurer insolvencies is inadequate reserves this guidance doesn't appear to be appropriate.

We believe that the deterministic methods continue to represent the best, most reliable tools that have been extensively tested and proven to produce reliable estimates. In contrast, stochastic models are rarely used outside of enterprise risk applications for P&C insurers. Accordingly a mandated accounting requirement to replace well functioning validated estimation models with a sparsely tested, largely non-validated (for the intended purpose) single model would result in P&C insurers continuing to run their deterministic models and then using that output to select stochastic model inputs and parameters to produce results that match the deterministic models. If this were to occur it would represent a highly inefficient use of time and money. We support revising the proposed guidance to ensure the final standard clearly allows a continuation of the application of the robust, time-tested deterministic actuarial methods and practices currently in use in the U.S. and elsewhere as these reserving methods produce the most reliable, comparable, and understandable measurements.

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 recognizing changes in the estimates of cash flows in net income as this is consistent with current practice. However, we do not support the discounting of claim reserves. See our responses to Questions 14 and 15.

VII. 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?*

We do not support discounting of P&C claim reserves without fixed and determinable payments.

However, if discounting P&C claim reserves becomes required, the following issues need to be considered:

- P&C claim reserves are non-interest bearing;
- P&C claim reserves cannot be settled on a discounted basis;
- No interest-bearing financial instruments exist with cash flows that match P&C claim reserves; and
- The cash flows associated with most P&C claim reserves are not fixed and determinable on an individual claim basis.

As a result of the above, there are no obvious proxies or other market-based information available to calibrate a discount rate for P&C claim reserves. Calibration of a P&C claim reserve discount rate to asset returns does not appear prudent as it could encourage investment in riskier investments with higher yields and could result in the ability to decrease reported reserves. If, despite being inconsistent with the desires of a majority of investors and not exceeding the cost/benefit threshold, discounting is required under the PAA, a practical expedient such as using the interest rate for AA Corporate Bonds could be introduced. This would decrease the complexity of the PAA proposal and enhance comparability.

Also, if discounting is ultimately introduced, we recommend changing the locked in discount/accretion date from “contract inception” to the “incurred date” as claims are managed by type and by incurred date. If the discounting requirements are not modified to reflect this fact the discounting mechanics would become extremely complex, as a variety of interest rate curves linked to contract inception dates would need to be applied to portfolios of claims.

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?*

As noted in our answer to Question 14, we do not believe P&C claim reserves, other than those with fixed and determinable payments, should be discounted. While discounting these claim reserves is supportable on a purely theoretical basis, because of the significant uncertainty in the timing and amount of claim payments, the information provided is of less practical use than the undiscounted amounts reported under current GAAP.

Currently, claim reserves in U.S. GAAP financial statements are measured on the same basis and can be reconciled to Statutory basis claim reserves. They can also be compared to the very granular claim data presented in the Statutory financial statements on Schedule P which provides reserve development statistics for a 10 year period by company and by major line of business.

Investors consider Schedule P a vitally important tool to assess an insurer’s ability to reliably estimate claim reserves. The current proposal would require different bases of measurement for claim reserves in the balance sheet (i.e., discounted) and for claim reserves presented in the Statutory claim development table disclosures (i.e., undiscounted). Investors have indicated that claim development information would be much less useful if presented on a basis different from the measurement basis for claim reserves in the balance sheet.

In addition to transparency and understandability issues, discounting of P&C claim reserves is not supported because it is not consistent with the P&C business model under which claims are typically managed internally, analyzed externally, and ultimately settled all on a nominal (i.e., undiscounted) basis. The introduction of discounting is therefore inconsistent with the P&C insurance business model, with the exception of contracts such as some workers’ compensation reserves where the claim amounts are fixed and determinable.

The existing business model separates underwriting from investing as investors typically invest in P&C insurers based on their ability to produce underwriting income versus investment income and in fact they typically put a different multiplier on each profit stream (higher for underwriting and lower for investing). The proposal would integrate investing activities into the underwriting model which will cause investors to back out the impacts of discounting to get back to reserves on a nominal basis. Under the PAA approach, the majority of P&C claim and claim expense reserves would likely be discounted unless the definition of a portfolio is modified to distinguish between a portfolio of claims v. a portfolio of contracts (as described in the ED). If portfolios are constructed on a “claim” basis certain auto physical damage and homeowners – property damage claims that are settled in one year or less would not be discounted. In contrast, if a portfolio is determined at the

contract level claims related to different perils would not be separated and the entire claim would be discounted.

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.*

As stated in our answers above we do not support the discounting of claim reserves. However, if claims must be discounted, insurers will be required to select and retain a yield curve for each insurance contract or group of contracts that would serve as the reference point for all future discounting (as the claim ages) and interest rate changes and the difference between the historical rate and the current rate is classified in OCI. Also, some believe the proposal may require each probability-weighted scenario to be discounted, which would add substantial complexity to OCI requirements. The costs to implement this guidance would be extremely high as most existing claim administration systems are set up on an accident year basis as opposed to contract inception.

Notwithstanding the desire by some insurers not to have short-term interest rate fluctuations run through the income statement, the proposed OCI treatment would introduce significant reporting complexity for P&C insurers.

The accretion of the discount creates further complexity and lack of transparency from underwriting operations. While the loss reserves on the balance sheet will be credited over time with the accretion of discount, the offsetting interest expense moves from AOCI to net interest expense rather than losses incurred. This being the case, the balance sheet and income statement become asymmetrical. The ultimate losses incurred never return to the nominal value. As a result, the combined ratio, a universally accepted industry metric, is distorted by the omission of the interest component reported in net investment income. This could lead to additional non-GAAP measures as issuers attempt to provide meaningful information for the benefit of investors and analysts for industry comparison purposes.

The OCI reporting requirement applies to claim reserves including incurred but not reported (IBNR) reserves, which are not typically estimated at a policy level, as well as reserves related to events that have not yet occurred as determined under the onerous contract provisions. This will require insurers to modify their claim reporting systems to accommodate the new requirements, the cost of which may be enormous. Information necessary to comply with the new requirements is not currently tracked; thus both policy administration and reserving systems would need to be modified at a substantial cost.

In addition, investors have indicated that presenting claim development disclosures (i.e., Schedule P type disclosures) on a basis that is inconsistent with the measurement method applied in the balance sheet will not be helpful.

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 believe Accumulated OCI would unwind as the liability is extinguished.

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?*

See answer to Question 14.

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?*

See answer to Question 14

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?*

N/A

VIII. Margin for Contracts Measured Using the Building Block Approach

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?*

N/A

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.*

N/A

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?*

N/A

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?*

N/A

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?*

N/A

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

N/A

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?*

N/A

IX. 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 acquisition costs should reflect all costs that are primarily related to the acquisition of insurance contracts, including those related to unsuccessful acquisition efforts. These costs are factored into the profitability of written insurance contracts.

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?*

We do not believe netting acquisition costs with the liability for remaining coverage for presentation purposes is appropriate as it reduces transparency.

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 for the PAA.

X. 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?*

As preparers, we believe current GAAP for short duration contracts provides the users of the financial statements a clear and useful presentation of insurance contract revenues and incurred expenses. We support maintaining current reporting for short duration contracts.

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 do not believe current accounting for loss sensitive nonlife contracts should be changed to bifurcate premium between pure risk transfer and potential expense recoupment for favorable loss experience. Whether a no claims bonus, contingent commission, or other commission adjustment, loss sensitive policies tend to align insurer and insured interests in loss control. These contingent payments, especially where there is significant uncertainty in expected loss costs, allow for more precision and fairness in the final cost paid by the insured. We believe payments of any bonus or

contingent amounts are business expenses and not a reduction of premiums, which are subject to state regulation.

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?*

We do not agree that the liability for remaining coverage under the PAA should be discounted. It adds unnecessary complexity and cost to the PAA model and does not provide additional value. The practical expedient should be used for all 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.*

N/A

XI. Participating Contracts

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?*

N/A

XII. 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 margin would be necessary to eliminate the gain at inception.

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 cash flows for reinsurance contracts and the underlying contracts should be measured consistently.

XIII. 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 would suggest an adjustment to goodwill, which is consistent with current business combination guidance.

XIV. 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?*

N/A

XV. 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 believe the current presentation requirements for short duration contracts should be maintained. The information presented currently, including disclosures, is well understood and provides decision useful information to the users of the financial statements. We do not believe the costs to restate the significant amount of historical data needed and the time, effort and expense that will be incurred to understand and interpret the proposed discounted loss reserves will result in a corresponding improvement in the financial reporting for short duration insurance contracts.

XVI. 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 proposed disclosures requirements are quite voluminous and complex and in the case of the disclosures required under Inputs, Judgments, and Assumptions, could be considered proprietary information. Our members believe current GAAP guidance for short duration contracts provides decision useful information in the financial statements which is adequately explained in the current footnote disclosures.

XVII. 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?*

We believe the most significant driver affecting the timing of implementation is the requirement to discount claim reserves for short-duration contracts. The costs and time to develop the expertise necessary to effectively: determine and maintain appropriate discount rates for the newly defined portfolios, explain this new information to both internal and external users of the financial statements, and develop the ability for comparisons with historical data will require significant physical and financial resources.

In addition, the requirement to use an unbiased probability weighted approach for determining cash flows will also create additional costs and require additional time to develop and understand the use of stochastic models rather than the deterministic models currently in in developing loss reserves.

It will take many years to test and implement these new systems, develop internal controls, train staff and educate the users of the financial statement on all the changes in the financial reporting by P&C insurers.

We do not believe that any incremental improvements in the financial reporting by P&C insurers warrant the significant proposed changes to current GAAP, which is well understood and provides decision useful information to the users of the financial statements.

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?*

As stated above we do not believe the proposed guidance for short-duration contracts should be implemented. If it is adopted, however, an extended implementation date should be allowed, but not required, for nonpublic companies

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?*

As stated above we do not believe the proposed guidance for short-duration should be implemented.

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?*

N/A

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 do not believe the proposed guidance would provide a more relevant information than is provided under current GAAP. The discounting of loss reserves will add an additional level of

uncertainty to the financial statements and will make comparisons to historical data extremely difficult. It has been stated over and over by the investment community that it is not supportive of the discounting of loss reserves.

XVIII. 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.*

The most significant initial and ongoing costs would be in developing and maintaining systems and procedures for the discounting of claim reserves, which, as indicated previously in this letter, we do not believe would result in improved decision useful information.

In addition there will be significant initial and ongoing costs for:

- Audit and compliance costs which will be incurred due to the greater complexity of the proposed standard;
- Costs of converting to an unbiased probability weighted estimate of cash flows;
- Cost of determining and maintain yield curves for on- going reporting of discounted claim reserves; and
- The loss of comparability to historical data related claim reserves that were not calculated on a discounted unbiased probability weighted estimate of cash flows

The best way to make the proposal more cost effective is to maintain current GAAP guidance for short- duration contracts which is well functioning and clearly understood by preparers, auditors and users.

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.*

N/A

If you have any questions or comments about our letter, please contact me at your convenience.



James M. Olsen