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United Services Automobile Association (USAA) is a privately-held membership-based association which, together with its family of companies, serves present and former commissioned and noncommissioned officers, enlisted personnel, retired military, and their families. Since USAA's inception in 1922 by a group of U.S. Army officers, we have pursued a mission of facilitating the financial security of our members and their families by providing a full range of highly competitive financial products and services, including personal lines insurance, retail banking and investment products. Our core values of service, honesty, loyalty and integrity have enabled us to perform consistently and be a source of stability for our members, even in the midst of the unprecedented financial crisis of recent years.

USAA has been actively engaged in evaluating the proposed Insurance Contracts Accounting Standards Update (Update) and would like to share the following observations with the Board.

<u>Definition of “Portfolio”</u>

Additional clarity needs to be given to the definition of a portfolio as we could interpret it very broadly or narrowly. For instance, should an auto insurance contract be broken into its individual perils (i.e.; separate physical damage from bodily injury) or should homeowners’ policies in Kansas be grouped with homeowners’ policies in coastal Florida? We suggest that the Board remove the provision which states “have similar duration and similar expected patterns of release of the single margin” to “managed together as a single pool” which is consistent with the International Accounting Standards Board’s definition of a portfolio.

<u>Use of OCI</u>

We applaud the efforts of the Board in attempting to remove accounting mismatches by requiring that the impact of changing discount rates be classified in OCI. In our case, segregation of the discount rate change actually <u>creates</u> an accounting mismatch. That is, currently our insurance investment portfolios are classified as “trading” and all mark-to-market impacts flow directly to net income. As such, we recommend that the Board modify the OCI provision to be consistent with how an insurer classifies its investment securities or make it optional.

Insurance Revenue

On the life side of our business, we currently record revenue when due from our policyholders whereas the Update stipulates that the timing of revenue recognition is commensurate with proportion of coverage and other services provided during the period. During our field test of whole life products issued to juveniles, we observed that virtually no revenue is recognized for 20 years and the margin actually accretes. As such, we recommend current GAAP for revenue recognition for contracts accounted for under the building block approach.

Margins

The Update proposes the establishment of a margin representing profit at risk, which is deferred and recognized as income as the uncertainty in the cash flows decreases. We have two concerns regarding the margin stipulations in the Update:

1. The margin is locked in at inception. We recommend that the margin be treated similar to FAS 97 unlocking. That is, the margin should be subject to adjustment under a fully retrospective model.
2. We also believe there should be a separate margin which incorporates the risk associated with the uncertainty of cash flows. The establishment and determination of adverse events with explicit disclosure would allow users to better understand the potential volatility of our insurance liabilities.

Pre-Event Catastrophe Reserves

The Update will 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 Update represents a significant change for both the recognition of premium deficiency reserves under existing GAAP as well as the treatment of subsequent events, potentially resulting in restatements during the reporting cycle.

Implementation and Operational Costs

As a nonlife personal lines writer with relatively short loss payout tails, during our field test we found that implementing the premium allocation approach did not materially alter our financial results. We also estimated that we would incur $10-15m of costs to modify our internally developed insurance systems. Therefore, we don't believe the benefit of implementing an entirely new insurance model outweighs the cost of such.

Fulfillment Cash Flows

Updating assumptions used in the measurement of fulfillment cash flows at each reporting period is a burdensome requirement. Most life assumptions move slowly and quarterly updates will yield immaterial changes in comparison to the increase in time and expense to update the assumptions. We believe that the expenses used to measure the fulfillment cash flows should include all expense expected to be allocated to the portfolio. By excluding some expenses, the margin is inflated and inconsistent with a fully allocated pricing approach and revenue is under stated under the approach outlined in the Update.

Nonlife Disclosures

While the bulk of this letter has centered on the shortcomings of the Update, we would like to offer a word of support for the type of nonlife disclosures outlined in section 834-10-50-21. We believe the current loss reserve disclosures are inadequate and disclosures like the one noted above are highly relevant regardless of which model you are using.

Again, we appreciate the opportunity to provide comments on the Update. Feel free to contact me should you have questions regarding our statements.

Sincerely,

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