



333 S. Wabash Ave. Chicago IL 60604

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**D. Craig Mense**  
*Executive Vice President and  
Chief Financial Officer*

*Telephone 312-822-1222  
Facsimile 312-822-2004  
Internet craig.mense@cna.com*

Ms. Susan M. Cospers  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

**Proposed Accounting Standards Update, Insurance Contracts (File Reference No. 2013-290)**

Dear Ms. Cospers:

CNA Financial Corporation (CNA, we, our, or us) appreciates the opportunity to comment on the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update, *Insurance Contracts* (Proposed Update). We are also separately providing comments to the International Accounting Standards Board (IASB) on its Exposure Draft ED/2013/7, *Insurance Contracts* (IASB ED). CNA is the eighth largest commercial insurance writer and the thirteenth largest property & casualty (P&C) writer in the United States and has insurance operations in both North America and Europe. In addition, CNA's non-core business includes life and group (L&G) lines of business that are in run-off. Loews Corporation owns approximately 90% of CNA's outstanding common stock.

We support the FASB's stated primary project objectives of improving and simplifying the financial reporting for insurance contracts. We also believe, as a secondary objective, that international convergence of the financial reporting requirements for insurance contracts would benefit both preparers and investors. While we acknowledge the theoretical merits of several individual aspects of the Proposed Update, we do not believe the resulting accounting models would provide more relevant, transparent, and comparable information that faithfully represents the performance and financial condition of a P&C reporting entity. In contrast, we believe comparability between periods and between peer companies would become exceedingly difficult, if not impossible. As a result, we do not believe the proposed accounting model for P&C insurers achieves the Board's primary stated objectives. We believe the resulting model for life insurers, with certain exceptions noted below, does meet the Board's primary objectives.

The Proposed Update would require significant changes that, in our view, will increase complexity, reduce transparency, and provide less precise financial reporting results for P&C contracts due to layering of estimates and judgments, including timing of cash flows, discount rates, and portfolio composition. In certain situations, these changes may introduce significant accounting-driven volatility into the income statement. Coupled with the voluminous proposed required disclosures, the financial statements will be overwhelming and difficult to understand and interpret. In addition, traditional measures of P&C performance, such as the loss ratio and combined ratio, will not be apparent to financial statement readers.

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For P&C contracts, several aspects of the proposed accounting models would require significant and complex changes in operational and actuarial processes that are not consistent with how we manage the business. We therefore expect implementation to be very difficult and costly. Such costs can only be justified if the new accounting model provides financial statement users with significantly improved transparency into the financial performance of the business, the underlying key judgments, and the risks and uncertainties related to those judgments. As stated above, we do not believe this criterion has been achieved. Our concerns with specific aspects of the Proposed Update are discussed in further detail below.

Furthermore, the Board has not achieved its secondary project objective of convergence with the IASB ED. Although the accounting models proposed by both the FASB and the IASB have similar fundamentals, significant differences remain regarding:

1. One model versus two models

The Premium Allocation Approach (PAA) was designed by the FASB as a simplified approach in comparison to the Building Block Approach (BBA) and is viewed as a separate model. The IASB views the PAA as a proxy for the BBA, and under the IASB ED, the PAA would be permitted, but not required, for contracts with coverage periods shorter than one year or where it is a reasonable approximation of the BBA.

2. Margin composition

In the FASB's BBA, the margin is viewed as unearned profit that is ratably recognized as insurance contract revenue as the associated cash flows become more certain. In contrast, the IASB ED includes an explicit risk adjustment in the measurement of the insurance contract liability and a contractual service margin that is recognized on a systematic basis in line with the pattern of services provided under the contract.

3. Margin unlocking

In the FASB's BBA, all changes in estimates (other than the effect of changes in the discount rates) are recognized immediately in net income and as an adjustment to the insurance liability. In contrast, in the IASB ED, a net increase in expected future cash outflows relating to future coverage or future services is offset against the remaining contractual service margin (other than for the effect of changes in discount rates), and a net decrease in expected future cash outflows is added. The risk adjustment is remeasured each reporting period with changes recognized immediately in net income.

4. Allocation period for recognizing margin

In the Proposed Update, the margin would be recognized in net income as part of insurance contract revenue over the coverage and settlement periods for contracts that apply the BBA. In the IASB ED, the contractual service margin would be recognized in net income as part of insurance contract revenue over the coverage period. The risk adjustment would be recognized in net income over the coverage and settlement period.

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5. Acquisition costs

In the Proposed Update, acquisition costs included in the measurement of the liabilities would be limited to acquisition costs directly attributable to a portfolio of insurance contracts that are successfully obtained. In the BBA, the margin would reflect expected profit after deducting acquisition costs incurred. In the IASB ED, the acquisition costs included in the measurement of the liabilities would include all acquisition costs directly attributable to obtaining a portfolio of insurance contracts, including costs related to unsuccessful efforts. In the IASB's BBA, the fulfillment cash flows would include expected acquisition costs.

6. Participation features

The FASB concluded that participating policies that do not have discretion as to the amount to be credited to policyholders should be measured on the same basis as the related assets and changes in the measurement should be presented in the same statements (i.e., net income or other comprehensive income) as the assets. This was referred to as "mirroring" during board deliberations. The IASB reached a similar conclusion, but extended that view to contracts where the insurer has a practice without a strict contractual linkage as to the percentage participation.

7. Reinsurance

The FASB decided that the cedant should account for a reinsurance contract using the same approach used to account for the underlying direct policies (e.g., if the cedant accounted for the direct policies using the PAA, the reinsurance contract would also be accounted for under the PAA). The IASB would require application of the classification criteria (i.e., use PAA only if it is a proxy for BBA) rather than defaulting to the classification of the direct contracts.

As an international company with operations subject to accounting principles generally accepted in the United States (U.S. GAAP) and international financial reporting standards (IFRS), the cost of implementing the proposed changes to insurance contracts guidance, as issued by the FASB and the IASB, will be significantly higher in the absence of true convergence.

In our review of the Proposed Update, we identified the following concerns and proposed refinements to the guidance. We are supportive of the FASB's view that the PAA and the BBA represent two distinct measurement models; therefore, where appropriate, have differentiated our concerns as they relate to either model. Furthermore, we believe that P&C insurers and life insurers operate different business models that require different accounting approaches to appropriately reflect the economics of two business models. Therefore, we have also differentiated our concerns with the Proposed Update as they relate to our P&C and L&G segments.

***Expected Value***

Under the guidance in the Proposed Update, for contracts accounted for using the PAA, the liability for incurred claims would be measured as the present value of the expected fulfillment cash flows (expected value) reflecting all available information on the amount, timing and uncertainty of the remaining future cash flows.

The application of this expected value approach to P&C contracts accounted for under the PAA represents a significant departure from the deterministic actuarial reserve measurement approach currently in use. Under the current accounting standards, carried reserves reflect management's best estimate (MBE) of the unpaid claim and claim adjustment expense liabilities of the company. For P&C companies, MBE is typically based on an actuarial central estimate (ACE) which is defined in Actuarial

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Standard of Practice No. 43, *Property/Casualty Unpaid Claim Estimates* (ASOP 43), as “an estimate that represents an expected value over the range of reasonably possible outcomes.” The detailed analyses performed use a variety of accepted actuarial methods and techniques to produce a number of estimates of ultimate loss. Our actuaries determine a point estimate, the ACE, of ultimate loss by reviewing the various reserve estimates and judgmentally assigning weight to each estimate given the characteristics of the product being reviewed. As this process may not include all conceivable outcomes, it produces a conceptual mean rather than an unbiased probability-weighted statistical mean. There is no current requirement (or recommendation) for the utilization of probability distributions to calculate the ACE and, in practice, most actuarial reserve analyses do not create explicit probability distributions. To force the creation of a distribution of outcomes and of payment patterns or cash flows will imply a level of sophistication and certainty that does not exist in the process. This could create a false impression of the ability of actuaries to quantify the uncertainty inherent in any reserve estimate.

Each quarter, the ACE, in conjunction with the results of the detailed reserve reviews, is discussed with our senior management to determine management’s best estimate of reserves. This group considers many factors in making this decision. The factors include, but are not limited to, the historical pattern and volatility of the actuarial indications, the sensitivity of the actuarial indications to changes in paid and incurred loss patterns, the consistency of claims handling processes, the consistency of case reserving practices, changes in our pricing and underwriting, pricing and underwriting trends in the insurance market, and legal, judicial, social and economic trends. Our recorded reserves reflect our best estimate as of a particular point in time based upon known facts, consideration of the factors cited above, and our judgment. The carried reserve may differ from the ACE as the result of our consideration of the factors noted above as well as the potential volatility of the projections associated with the specific product being analyzed and other factors impacting claims costs that may not be quantifiable through traditional actuarial analysis. However, the carried reserve is still within the range of reasonably possible outcomes as determined by the actuaries. This process results in MBE.

The removal of management judgment from the reserve estimation process would generally result in a reduction in nominal loss reserves and increased volatility in earnings. We do not believe this outcome would be in the best interest of users of the financial statements or policyholders to the extent that it adversely affects the insurer’s solvency.

Without full stochastic modeling, which is costly and not always practical or prudent, we believe the expected value approach outlined in the Proposed Update suggests a level of certainty in the model that should not be reasonably relied upon. We believe the final guidance should set forth a broader principle and allow the actuarial profession to set the standards on how that principle will be met. We do not believe that preparers should be restricted in their approaches and we do not believe accounting standards should govern the actuarial profession or how actuarial estimates are derived. We believe the two-model approach proposed by the FASB provides the required flexibility to differentiate between appropriate expected value calculation approaches for both the PAA and the BBA models. In addition, we believe that management is ultimately responsible for the appropriateness of the estimates recorded in the financial statements; therefore, management should have the latitude to adjust the ACE reserve estimate, if deemed appropriate.

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### ***Time Value of Money***

In general, we agree with the theoretical merits of reflecting the time value of money in the measurement of the fulfillment cash flows. However, with respect to the P&C industry, we question whether the significant complexity introduced by this requirement is supported by improved decision-useful information. With the exception of reserves that are fixed and reliably estimable, the introduction of discounting is inconsistent with how we manage our business. Underwriting performance is typically measured internally and analyzed externally on a nominal basis. This is the same basis upon which the claims are settled (i.e., on a nominal versus a discounted basis).

As discussed in our *Expected Value* commentary above, there is inherent uncertainty involved in the estimation of the ultimate loss reserves on a nominal basis. Uncertainty also exists, to an even greater extent, in estimating the timing of the payment of losses and all of the other contract fulfillment elements. A liability accounting measure that is based on measuring cash flows rather than the ultimate liability introduces more judgment, subjectivity and variation. While true for all policies, this issue is compounded for longer-tail exposures, such as workers compensation and asbestos and environmental pollution liabilities.

The requirement to discount loss reserves will introduce significant accounting-driven volatility into the income statement. Accounting-driven volatility will arise in situations where the total nominal loss reserves are not adjusted, but the allocation of those reserves by policy year changes. The re-estimation of loss reserves between policy years, which occurs frequently, would require the application of different yield curves to the loss reserves transferred. Additionally, the re-estimation of loss reserves between expected payment dates would require the application of different points on the same yield curve for income statement measurement. The net impact on a present value basis will be reflected in the income statement as underwriting income or loss. The interest expense would also be impacted on a go-forward basis due to changes in accretion rates. We do not believe this volatility, which would need to be explained by management, is meaningful to users.

We understand that current U.S. GAAP guidance produces a mixed-attribute accounting model with most investment assets being measured at fair value and P&C insurance contract liabilities being measured on a nominal basis. However, this should not be a cause for concern. As noted above and throughout this comment letter, the current accounting model is well understood by users as they evaluate the insurer's performance and provides decision-useful information. The measurement of investment assets is consistent with other industries, while the measurement of P&C loss reserves on a nominal basis reflects the manner in which we manage our business.

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 they typically apply a different multiplier on each profit stream (higher for underwriting and lower for investing) to determine their enterprise valuations. The Proposed Update would integrate investing activities into the underwriting model, which will likely cause investors to back out the impacts of discounting to get back to reserves on a nominal basis.

Under the Proposed Update, insurers will be required to select and retain a yield curve for each insurance contract or group of contracts, which would serve as the interest accretion rate for the interest expense calculation and as the reference point for recognizing changes to fulfillment cash flows due to changes in the discount rates in other comprehensive income (OCI). The guidance provided in the Proposed Update

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is not clear as to how this requirement should be implemented. This issue is discussed in further detail in our response to Question 15.

The Proposed Update requires that discount rates reflect the characteristics of the insurance contract liability but acknowledges that discount rates may not be observable in the market. We suggest, as a practical solution to improve comparability among insurers, that the Board propose that non-linked contracts (i.e. non-participating contracts) be discounted using a high quality corporate bond rate, similar to the requirement of Accounting Standards Codification (ASC) Topic 715, *Compensation – Retirement Benefits* (ASC 715). This issue is discussed in further detail in our responses to Questions 14 and 18.

As the concept of time value of money applies to the PAA, we do not agree with the proposed requirement to discount the liability for remaining coverage if the contract has a financing component that is significant. We do not believe that the additional complexity introduced by this requirement is supported by improved decision-useful information. Although we currently do not have a significant number of policies that would fall outside the practical expedient, changing economic conditions may result in more P&C contracts being structured over a period longer than 12 months.

### ***Definition of a Portfolio***

The definition of a portfolio is fundamental to the application of the Proposed Update. The portfolio is the unit of account used to estimate the expected fulfillment cash flows, determine and recognize the margin and acquisition costs, and perform the onerous contract test. The Proposed Update redefines a Portfolio of Insurance Contracts as a group of contracts that (1) are subject to similar risks and priced similarly relative to the risk taken on and (2) have similar duration and similar expected patterns of release from risk. Despite the importance of the portfolio concept, we do not believe that the Proposed Update provides sufficient consistent guidance on how preparers should apply the new definition in practice. Specifically, we believe the application guidance in paragraphs 834-10-55-47 through 834-10-55-50 is inconsistent with how we manage our business and with the intent of the Board as expressed in the Basis for Conclusions.

In paragraph BC120 of the Proposed Update, the Board rejected requiring that a portfolio consist of contracts by line of business or product type. The Board concluded that to group contracts by line of business would group contracts at a fairly granular level, which typically would be subsets of contracts with similar risks. In addition, those terms could be interpreted differently in different jurisdictions. This conclusion, however, would appear to be inconsistent with the implementation guidance in paragraph 834-10-55-48. This guidance provides factors to consider in determining whether contracts are subject to similar risk, including the type of risk insured, the product line, the type of policyholder, and the geographic location. If an entity is required to consider all of these factors, it may result in very granular definitions of portfolios. This would have adverse implications from the perspective of operational complexity and the required assessment of onerous contracts. Increased disaggregation of portfolios will increase the likelihood that onerous contract portfolios will be identified, which could lead to a change in the earnings pattern recognition (i.e., losses on certain portfolios would be recorded up front followed by gains on the remaining portfolios thereafter) and a reduced ability to compare performance across time and between insurers. We recognize that total income over the entire life of a contract (or group of contracts) will not change; however, periodic results may exhibit substantially more accounting-driven volatility.

In addition, paragraph 834-10-55-50 of the Proposed Update provides an example of determining the appropriate portfolio grouping level. Given the requirement for the margin to be determined at inception

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and to use interest rates applicable at inception, we believe that a portfolio can only comprise contracts written within the same reporting period (e.g., quarterly). However, the example suggests that contracts that have similar durations can be grouped together into a portfolio if the patterns of release from risk are similar, even if the contracts are written in different reporting periods. The example does not explain how the insurance liabilities, including margin, would be accreted at the required inception date discount rates for contracts so grouped that began in different periods.

We believe that the Board should set forth principles for determining portfolios; for example, to (1) prevent the combination of contracts that have significantly different expected loss ratios and, thus, delay recognition of losses, and (2) recognize revenue, from the margin, consistently regardless of whether contracts are combined or earned separately. The Board should avoid providing further rules around these principles which may only serve to confuse the intended purpose. As the concept of the portfolio applies to discounting, we believe that the interest accretion rate needs to be determined at a sub-portfolio level, defined as the portfolio of contracts entered into during a specified period of time – e.g. the contracts within a portfolio written in a particular quarter.

### ***Onerous Contracts - PAA***

The Proposed Update defines an onerous contract as:

A contract in which the present value of the future costs of fulfilling the unexpired portion of coverage (that is, the **liability for remaining coverage**) and the expected qualifying acquisition costs are expected to exceed the **carrying amount** of the liability related to the unexpired portion of coverage.

The Proposed Update requires entities to determine whether insurance contracts are onerous during the precoverage period if the entity can no longer withdraw from its obligation to provide insurance coverage to policyholders for insured events. Currently, the majority of insurers do not have systems or processes in place designed to capture and recognize data as of the contract binding date. Insurers would incur significant costs to modify systems and make process changes in order to account for the proposed recognition for seemingly minimal to no benefit. We believe the intent of this guidance is to immediately recognize losses for potentially onerous contracts, which would be extremely rare during the precoverage period as insurers do not knowingly enter into unprofitable contracts. In addition, the precoverage period is typically a relatively short period as compared with the total contract boundary period.

Under the onerous contract model, entities would be required to consider expected costs related to future events that have not yet occurred, and include those costs within the expected probability-weighted estimate of the future cash outflows. This requirement is in direct conflict with the underlying concept of the liability for incurred claims, which estimates future cash flows relative to a claim that has already been incurred, and becomes problematic when possible catastrophe events are contemplated prior to a period end date but are not expected to occur, if at all, until subsequent to the period end date. The guidance as written requires entities to assign a probability of loss occurrence to the event and also to estimate claim and claim adjustment expense liabilities in the event of occurrence. We do not support this guidance. We believe it to be inconsistent with other U.S. GAAP (e.g. ASC Topic 450, *Contingencies* (ASC 450)), and we believe that probabilistic-based measurement of the liability arising from low frequency, high severity events would lead to non-comparability as there is generally insufficient data available to develop and corroborate the probabilities of these types of events.

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We believe the proposed guidance for onerous contracts should exclude low frequency, high severity events unless the event is probable and reasonably estimable at the balance sheet date, using only information that theoretically existed at the balance sheet date. This approach would be consistent with current industry guidance and U.S. GAAP, would provide decision-useful information, and would be operationally easier to implement. Chapter 3 of the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Property and Liability Insurance Entities*, notes that it would be rare to have a catastrophe event that would meet both criteria of being probable of occurring and being able to reasonably estimate the extent of the damage, using information that theoretically existed at the balance sheet date. For example, potential losses from a hurricane sitting off the coast of Florida at period end that hits the coast and causes damage shortly thereafter in the subsequent accounting period would rarely meet the criteria of being both probable and reasonably estimable, using information that theoretically existed at the balance sheet date. As a result, the hurricane should not be included in a premium deficiency calculation.

Furthermore, we believe this view is also supported by ASC 450. ASC Subtopic 450-20, *Loss Contingencies*, requires that before an estimate for a loss contingency can be accrued, (1) it is probable that the loss has occurred and (2) the amount of the loss can be reasonably estimated.

Due to the nature of many catastrophe events, it is not possible to know in advance with a high degree of certainty the following:

- When, or if, the catastrophe event will occur;
- The exact location of the event. A catastrophe event hitting a densely populated area would result in a significantly greater expected loss than an event hitting a less densely populated area just a few miles away;
- The magnitude of the event;
- Types of damages subject to coverage;
- Existence of deductibles, self-insured retentions, reinsurance coverage that could materially vary depending on the above variables.

More often than not, the above variables only become resolved in the days and weeks after a significant catastrophe event. We are also concerned that the Proposed Update does not provide clear guidance as to appropriate sources of market data for the calculation of probabilities. For example, if a meteorologist releases a report at the beginning of the year that predicts ten severe weather events during the year, would all companies consider this report in the same manner? Also, how would companies reconcile conflicting data regarding the probability and magnitude of future catastrophe events?

Due to the above listed concerns, we do not believe the proposed changes to the guidance for onerous contracts under the PAA represent an improvement to the existing guidance for premium deficiency testing. We believe the inclusion of an onerous liability in the financial statements, caused by a potential catastrophe event occurring in a subsequent period, introduces unnecessary volatility. By the time the financial statements are issued, it is more likely that entities will know whether the catastrophe event did occur, and if so, have a more reliable estimation of the liabilities incurred. A disclosure of such information would be more meaningful than the inclusion of an onerous liability based on a probability-weighted estimate of the impact of the event.

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### ***Unbundling***

Under the proposed guidance, an insurer would be required to separate its insurance contracts into non-insurance components and insurance components and measure the non-insurance components under other standards. In addition to unbundling certain embedded derivatives and investment components, an insurer would be required to unbundle distinct performance obligations to provide goods and services. The Proposed Update states that a performance obligation to provide a good or service is considered distinct if either of the following criteria is met:

- The policyholder (or its beneficiary) can benefit from the good or service either on its own, or together with other resources that are readily available to the policyholder, or
- The entity's promise to transfer the good or service to the policyholder (or its beneficiary) is separable from the promises associated with the insurance component of the contract.

Although the Proposed Update states that the fact that an entity regularly sells a good or service separately would indicate that a policyholder or its beneficiary can benefit from the good or service either on its own or together with other readily available resources, it is not clear if we should reach the same conclusion if the good or service is sold separately by another entity and not us. In the IASB ED, paragraph B34(a) states that a performance obligation to provide a good or service is distinct if the entity **(or another entity** that does or does not issue insurance contracts) regularly sells the good or service separately in the same market or same jurisdiction. It is also not clear if the customer must have the ability to "opt-out" of the services and either perform such services themselves or use a third party for the services to be distinct.

As this concept relates to claims processing services, we believe the Board intended that performance obligations would only be considered distinct if (1) they were offered as a standalone service by the insurer to the policyholder; and (2) were for periods during which the insurer did not have insurance risk, due to the nature of the contract – e.g. a stop-loss coverage with a high limit. If the intent of the Board is to require insurers to unbundle claims processing services on all policies if such services were offered on a standalone basis for a subgroup of customers or a subgroup of policies, we do not support this requirement. It would be an overly complex exercise to bifurcate the insurance premium between the insurance coverage and the claims processing services. It introduces an information burden on the reporting entity as market participant information may not be readily available, or may be available at a cost that is not justified by the benefits of the information. In addition, we see little benefit with requiring this unbundling, as the majority of PAA contracts will recognize insurance contract revenue over a one-year period in the same pattern as the revenue would be recognized for the claims processing services under ASC Topic 605/606, *Revenue Recognition* (ASC 605/606). Further clarification of the guidance on this issue would be appreciated.

### ***Premium Allocation Approach***

As proposed, the PAA would be required for contracts that have a coverage period of one year or less, or 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 net cash flows. We do not agree with the restrictive nature of these criteria primarily due to the concern that certain similar contracts could have different measurement models and presentation. This would not be efficient or produce useful, consistent information for users of the financial statements. We believe the PAA should be available for application for all short-duration insurance contracts as defined under current U.S. GAAP in ASC Topic 944,

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*Accounting and Reporting by Insurance Enterprises.* We disagree with the Board's concerns with the current U.S. GAAP requirements for using the short-duration model as identified in paragraph BC113. We do not believe the current guidance has resulted in widespread issues in practice regarding the application of the incorrect accounting model.

We are also concerned that the guidance provided with respect to determining whether a contract has significant variability in the expected value of net cash flows is not clear and may lead to inconsistent application. Of the 13 examples provided in paragraph 834-10-55-53 for the determination of the measurement model to be applied to an insurance contract, seven relate to the PAA. However, of those seven examples, five are for contracts with a coverage period of one year or less. We do not find these examples particularly helpful, as contracts with coverage periods of one year or less are, by default, accounted for under the PAA. The two PAA examples provided for contracts with coverage periods greater than one year do not adequately explain the concept of significant variability in the expected value of net cash flows.

One of the two PAA examples provided for contracts with coverage periods greater than one year is for a contract surety bond. In this example, a PAA conclusion was reached because the contractor's financial position is stable and the contractor historically completed construction projects on time. A contract duration of three years was assumed. In practice, it is not uncommon for contract surety bonds to extend up to ten years. Based on the implementation guidance provided, it is unclear at what point (i.e. length of contract) a contract has significant variability in the expected value of the net cash flows during the period before a claim is incurred. If, at contract inception, the contractor's financial position is stable and the contractor historically completed construction projects on time would a five or a seven year contract qualify for PAA? In addition, how should an entity determine the significance threshold? One indicator provided in paragraph 834-10-55-52 is if an entity expects at contract inception that during the contract's coverage period it will significantly change premium pricing for future contracts written with similar or identical risks. However, general economic conditions and market forces often dictate pricing changes, not a re-pricing of risk. Further guidance on this issue would be appreciated.

If the proposed criteria to account for insurance contracts under the PAA are not revised to incorporate all similar contracts, we believe the PAA should be permitted, but not required. Some entities may find it operationally easier to apply the BBA model to all of their contracts, or all contracts for a particular product, rather than to have two different accounting methodologies, and we do not believe they should be precluded from doing so if they so choose.

### ***Reinsurance***

We agree with the Board's view that there should be symmetry between the recognition and measurement of reinsurance contracts and the underlying ceded contract. In the absence of such symmetry, as is the case in the IASB ED, there could be situations where a reinsurance contract is accounted for using the BBA and the underlying contract is accounted for using the PAA. This may result in a reinsurance receivable balance being recognized prior to the recognition of the related reserves on the underlying ceded contract. This resulting outcome would produce non-decision-useful information and would be confusing and difficult to analyze.

We do not agree with the proposed change in guidance concerning the accounting for ceding commissions. The Proposed Update requires that ceding commissions paid to the cedant that are not loss sensitive be treated as a reduction in premiums paid by the cedant. Under current U.S. GAAP, ceding commissions represent recovery of acquisition costs that reduce capitalized acquisition costs. We believe

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that current U.S. GAAP is a better reflection of the economics of the transaction. From a presentation perspective, it makes sense for the insurance and reinsurance premiums to mirror each other. Under the Proposed Update, for a contract that was 100% reinsured, netting the ceding commissions with the reinsurance premium would result in a residual net premium being presented in the income statement.

### ***Presentation***

The Proposed Update states that an insurer may not aggregate portfolios in a net asset position with those in a net liability position. In addition, balances relating to PAA portfolios must be presented separately from BBA portfolios. We believe that this proposed presentation is too detailed and may clutter the balance sheet, especially if an entity has insurance and reinsurance contracts under both models and non-insurance operations. We also believe the proposed segregation of portfolios in a net asset position from those in a net liability position will add to the complexity of preparing and reviewing the financial information. In our opinion, the FASB's proposal could be simplified by requiring a level of presentation more akin to the IASB ED, which allows one line for insurance contract assets and one line for insurance contract liabilities, without distinguishing between the BBA and the PAA measurement models.

With respect to qualifying acquisition costs, we support the measurement of the margin for contracts measured using the BBA and the liability for remaining coverage for contracts measured using the PAA being reduced for direct acquisition costs incurred. However, we believe that this results in a lack of symmetry between the income statement and balance sheet. This is an unnecessary complication and does not provide decision-useful information. In addition, the Board provides a practical expedient under the PAA to expense all qualifying acquisition costs as incurred, leading to recognition of these expenses within "other insurance expenses." It would be more appropriate to present amortization and/or expense of qualifying acquisition costs consistently.

In addition, similar to our comments above on the balance sheet, we believe the proposed guidance for income statement presentation is too detailed and may clutter the income statement. We prefer the IASB's proposed statement of comprehensive income presentation, which is more streamlined.

### ***Disclosures***

The proposed disclosure requirements are more detailed than current requirements and will significantly impact system requirements. The voluminous nature of these disclosures will be overwhelming to users and difficult to understand and interpret. Specifically, we are concerned with the required disclosures of fulfillment cash flows grouped in prescribed time bands, and, for each time band, the corresponding weighted-average interest accretion rates and the weighted average current discount rates. Weighted-average interest accretion rates by time band become less meaningful as contracts from different economic cycles are grouped into the same time band. Therefore, the weighted-average accretion rate disclosed will not be comparable across entities with insurance contract liabilities that originated in different periods, as this will distort the weighted-average nature of the calculation. Should the Board continue to pursue this type of disclosure, we believe that disclosing quantified ranges would be more appropriate.

We are also concerned with the proposed requirement to reconcile the disclosure of the undiscounted amount of claims on an accident-year basis with the carrying amount of the insurance contract liabilities in the statement of financial position. This reconciliation will be complicated by the different measurement bases (i.e. discounted vs. undiscounted) and by the fact that insurance contract liabilities are recorded as the liability for incurred claims for contracts measured under the PAA model and insurance

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contract asset/liability, which itself is a net balance, for contracts measured under the BBA model. This complexity will limit the decision-usefulness of the information for users of the financial statements. In addition, we believe that users will focus primarily on the undiscounted amount of the claims on an accident-year basis, rather than the discounted carrying amount.

### *Summary*

Throughout its deliberations that led to the guidance in this Proposed Update, the Board considered whether the expected improvement in the usefulness of the information—improvements in its relevance and the extent to which it faithfully represents what it purports to represent—justifies the costs that stakeholders are likely to incur to prepare and use that information. We do not believe that the guidance in this Proposed Update, as it applies to P&C insurers, yields a sufficient overall improvement in decision-useful information to investors and other users of financial statements to justify the significant overall costs and complexity it will add. Several aspects of the accounting models proposed would require significant changes in operational and actuarial processes that are complex and are not consistent with how we manage the business. For P&C insurers, we believe the adoption of the Proposed Update will result in increased use of non-GAAP measures. However, we do believe, subject to certain exceptions noted in this letter, that the Proposed Update, as it applies to life insurers, meets the Board's primary objectives.

U.S. GAAP for P&C contracts is well established and has been used globally without posing significant issues with regard to application, auditing, and analysis. Generally, users understand the accounting and reporting for P&C contracts, and that information, including the performance metrics that are reported to users, is consistent with how management reviews performance of the business. Additionally, the uncertainty regarding the estimation of the claims liability is well understood with significant disclosure regarding the risks and uncertainties in the Critical Accounting Estimates section of the Management's Discussion and Analysis section of Form 10-K of Securities and Exchange Commission (SEC) filers.

As previously noted, we acknowledge the theoretical merits of several individual aspects of the proposal. However, when considered in totality and in conjunction with overall feedback provided to the Board by preparers and users, we believe that the magnitude of the costs and complexity that the P&C model would add is not justified. Therefore, until a more targeted, less costly and less complex proposal is developed, we would prefer to retain the current recognition and measurement model for P&C insurance contracts.

We believe that the Board should pursue the development of the Proposed Update for non-P&C contracts only and take a targeted approach to improving existing U.S. GAAP as it applies to P&C contracts. The Board should consider addressing the following areas:

- Broadening the scope of the guidance to cover noninsurance entities that issue insurance contracts; and
- Clarifying the risk transfer requirements for insurance contracts.

While the scope of these changes would be limited, we believe that they would improve comparability of the reporting of similar types of insurance contracts.

Should the Board continue to pursue the guidance in its current form, due to the pervasiveness of the proposed changes, we recommend that the FASB and IASB work closely with the insurance industry to comprehensively test the proposals using real data before finalizing the standard. This would help to

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ensure that the models will produce information that is relevant to the decision-making needs of users at a reasonable cost. The Board should also take the results of the field testing into consideration when setting the effective date for the proposed standard.

The remainder of this letter addresses the specific questions applicable to CNA contained in the Proposed Update and further elaborates on our conclusions.

If you have any questions, please feel free to call me at 312-822-1222.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Mense". The signature is fluid and cursive, with a large initial "D" and a long, sweeping underline.

D. Craig Mense

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## Questions for Respondents

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### Scope

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

**Response 1:** Yes, we agree that the scope of the Proposed Update based on the definition of an insurance contract, rather than the type of entity issuing the contract, would improve financial reporting and comparability between entities issuing insurance contracts. However, we have significant concerns regarding the Proposed Update as it relates to P&C contracts, as noted in our cover letter as well as the responses to the questions below.

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### Recognition

***Question 2:** Do you agree with the requirements included in this proposed Update for when non-insurance 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?*

**Response 2:** Yes, we agree that if a component is not closely related to the insurance contract, an insurer should account for that component as if it were a separate contract and apply the relevant standard to that specific component. We believe this would provide transparency and insight into the components of an insurance contract that do not respond to changes in circumstances in the same manner as components affected by insurance risk.

However, we do not believe that the Proposed Update clearly articulates whether performance obligations to provide a good or service would be considered distinct. The Proposed Update states that a performance obligation to provide a good or service is considered distinct if either of the following criteria is met:

- The policyholder (or its beneficiary) can benefit from the good or service either on its own, or together with other resources that are readily available to the policyholder, or
- The entity's promise to transfer the good or service to the policyholder (or its beneficiary) is separable from the promises associated with the insurance component of the contract.

Although the Proposed Update states that the fact that an entity regularly sells a good or service separately would indicate that a policyholder or its beneficiary can benefit from the good or service either on its own or together with other readily available resources, it is not clear if we should reach the same conclusion if the good or service was sold separately by another entity and not us. In the IASB ED, paragraph B34(a) states that a performance obligation to provide a good or service is distinct if the entity (**or another entity** that does or does not issue insurance contracts) regularly sells the good or service separately in the same market or same jurisdiction. It is also not clear if the customer must have the ability to "opt-out" of the services and either perform such services themselves or use a third party for the services to be distinct.

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As this concept relates to claims processing services, we believe the Board intended that performance obligations would only be considered distinct if (1) they were offered as a standalone service by the insurer to the policyholder; and (2) were for periods during which the insurer did not have insurance risk, due to the nature of the contract – e.g. a stop-loss coverage with a high limit. If the intent of the Board is to require insurers to unbundle claims processing services on all policies, if such services were offered on a standalone basis for a subgroup of customers or a subgroup of policies, we do not support this requirement. It would be an overly complex exercise to bifurcate the insurance premium between the insurance coverage and the claims processing services. It introduces an information burden on the reporting entity as market participant information may not be readily available, or may be available at a cost that is not justified by the benefits of the information. In addition, we see little benefit with requiring this unbundling, as insurance contract revenue will be recognized on the majority of PAA contracts over a one year period in the same pattern as the revenue would be recognized for the claims processing services under ASC 605/606. Further clarification of the guidance on this issue would be appreciated.

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**Initial and Subsequent Measurement**

***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?*

**Response 3:** While we acknowledge the theoretical merits of several individual aspects of the Proposed Update, we do not believe the resulting accounting models would provide more relevant, transparent, and comparable information that faithfully represents the performance and financial condition of a P&C reporting entity. In contrast, we believe comparability between periods and between peer companies would become exceedingly difficult, if not impossible. As a result, we do not believe the resulting accounting model for P&C insurers achieves the Board's primary stated objectives. We believe the resulting model for life insurers, with certain exceptions noted below, does meet the Board's primary objectives.

The Proposed Update would require significant changes that, in our view, will increase complexity, reduce transparency, and provide less precise financial reporting results for P&C contracts due to layering of estimates and judgments, including timing of cash flows, discount rates, and portfolio composition. In certain situations, these changes may introduce significant accounting-driven volatility into the income statement. Coupled with the voluminous proposed required disclosures, the financial statements will be overwhelming and difficult to understand and interpret. In addition, traditional measures of P&C performance, such as the loss ratio and combined ratio, will not be apparent to financial statement readers.

For P&C contracts, several aspects of the proposed accounting models would require significant and complex changes in operational and actuarial processes that are not consistent with how we manage the business. We therefore expect implementation to be very difficult and costly. Such costs can only be justified if the new accounting model provides financial statement users with significantly improved transparency into the financial performance of the business, the underlying key judgments, and the risks and uncertainties related to those judgments. As stated above, we do not believe this criterion has been achieved. Our concerns with specific aspects of the Proposed Update are discussed in further detail below.

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Furthermore, the Board has not achieved its secondary project objective of convergence with the IASB ED. Although the accounting models proposed by both the FASB and the IASB have some similar fundamentals, significant differences remain. As an international company with operations subject to U.S. GAAP and IFRS, the cost of implementing the proposed changes to insurance contracts guidance, as issued by the FASB and the IASB, will be significantly higher in the absence of true convergence.

As noted in our cover letter and further discussed in the following questions, we have significant concerns that the proposed changes will not produce relevant information that will help users of an entity's financial statements make economic decisions. Our most significant concerns include the following:

- **Application of the expected value approach** – The application of the expected value approach to P&C contracts represents a significant departure from the deterministic actuarial reserve measurement approach currently in use and suggests a level of certainty in the model that should not be reasonably relied upon. We do not believe that this requirement will produce relevant information that will help users of an entity's financial statements make economic decisions. See our response to Question 12 for further discussion of our concerns.
- **Application of the time value of money criterion** – With respect to the P&C industry, we question whether the significant complexity introduced by this requirement is supported by improved decision-useful information. We do not believe that this requirement will produce relevant information that will help users of an entity's financial statements make economic decisions. See our responses to Questions 15 and 33 for further discussion of our concerns.
- **Definition of portfolio** – It is unclear how to apply the proposed definition of portfolio. The Board should instead set forth principles for determining portfolios; for example, to (1) prevent the combination of contracts that have significantly different expected loss ratios and, thus, delay recognition of losses, and (2) recognize revenue, from the margin, consistently regardless of whether contracts are combined or earned separately. As currently defined, we do not believe that the definition of portfolio will produce relevant information that will help users of an entity's financial statements make economic decisions. See our response to Question 8 for further discussion of our concerns.
- **Recognition of onerous contracts under the PAA** – Recognition of onerous contracts in the precoverage period would be extremely rare as insurers do not knowingly enter into unprofitable contracts. Such recognition will not produce more relevant information that will help users of an entity's financial statements make economic decisions. In addition, the proposed probabilistic-based measurement of low frequency, high severity events would lead to non-comparability and decreased usefulness of the financial statements as there is generally insufficient data available to develop and corroborate the probabilities of these types of events.
- **Unbundling** – For P&C contracts, we see little benefit to unbundling, as the majority of PAA contracts will recognize insurance contract revenue over a one year period in the same pattern as the revenue would be recognized for the claims processing services under ASC 605/606. As such, we do not believe that this requirement will produce incrementally more relevant information to help users of an entity's financial statements make economic decisions. Should the Board require unbundling, we do not believe it will provide additional decision-useful information to require an insurer to evaluate whether a third party sells the good or service separately, due to the potential

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for limited market data on the pricing of such goods and services. See our response to Question 2 for further discussion of our concerns.

- **Premium allocation approach** – We do not agree with the restrictive nature of the criteria for applying the PAA primarily due to the concern that certain similar contracts could have different measurement models and presentation. This would not be efficient or produce relevant information to help users of an entity’s financial statements make economic decisions. We believe the PAA should be available for application for all short-duration insurance contracts as defined under current U.S. GAAP in ASC 944. See our responses to Questions 5, 6, and 7 for further discussion of our concerns.
- **Reinsurance** – While we agree with the Board’s view that there should be symmetry between the recognition and measurement of reinsurance contracts and the underlying ceded contract, we have significant concerns regarding the treatment of ceding commissions. Under the Proposed Update, for a contract that was 100% reinsured, netting the ceding commissions with the reinsurance premium would result in a residual net premium being presented in the income statement, which we do not believe would produce more relevant information for users of the financial statements. See our responses to Questions 36 and 37 for further discussion of our concerns.
- **Presentation and disclosure** – The proposed presentation requirements are too detailed and unnecessarily clutter the balance sheet and income statement. In addition, the proposed disclosure requirements are more detailed than current requirements and will significantly impact system requirements. The voluminous nature of these disclosures will be overwhelming and difficult to understand and interpret. As such, we do not believe that the proposed requirements will produce relevant information that will help users of an entity’s financial statements make economic decisions. See our responses to Questions 40 and 41 for further discussion of our concerns.

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

**Response 4:** While we acknowledge the theoretical merits of the fulfillment approach and the proposed building blocks, we do not believe that the guidance in the Proposed Update will significantly improve information provided to users of the financial statements. Specifically, the increased use of judgment and estimates will simultaneously increase complexity and reduce comparability and transparency of the financial statements. In addition, the introduction of accounting-driven volatility due to the recognition of the effects of changes in estimates in net income each period will decrease the decision-usefulness of the financial statements.

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**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?*

**Response 5:** Notwithstanding our general concerns with the Proposed Update, as noted above, should the Board finalize the guidance as proposed, we agree that entities should apply different approaches to contracts with different characteristics due to different economics of different products. Specifically, we believe that P&C insurers and life insurers operate different business models that require different accounting approaches to appropriately reflect the economics of two business models. However, we have significant concerns related to the determination of the appropriate approach to apply (PAA vs. BBA), as well as specific aspects of the PAA and BBA. These concerns are addressed in more detail both in our cover letter and throughout our responses to the following Questions for Respondents.

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**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?*

**Response 6:** As proposed, the PAA would be required for contracts that have a coverage period of one year or less, or 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 net cash flows. We do not agree with the restrictive nature of these criteria primarily due to the concern that certain similar contracts could have different measurement models and presentation. This would not be efficient or produce useful, consistent information for users of the financial statements. We believe the PAA should be available for application for all short-duration insurance contracts as defined under current U.S. GAAP in ASC 944. We disagree with the Board's concerns with the current U.S. GAAP requirements for using the short-duration model as identified in paragraph BC113. We do not believe the current guidance has resulted in widespread issues in practice regarding the application of the incorrect accounting model.

We also have concerns with the application of the definition of the contract boundary. Specifically, we disagree with the requirement to recognize onerous contracts in the pre-coverage period. We discuss this concern in more detail in our response to Question 9.

If the proposed criteria to account for insurance contracts under the PAA are not revised to incorporate all similar contracts, we believe the PAA should be permitted, but not required. Some entities may find it operationally easier to apply the BBA model to all of their contracts, or all contracts for a particular product, rather than to have two different accounting methodologies, and we do not believe they should be precluded from doing so if they choose.

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**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?*

**Response 7:** As noted in our response to Question 6, we disagree with the restrictive nature of the criteria used to evaluate whether a contract qualifies for the PAA, primarily due to the concern that certain similar contracts could have different measurement models and presentation.

It is not clear how to evaluate whether a contract has significant variability in the expected value of net cash flows and as such there may be inconsistent application. Of the 13 examples provided in paragraph 834-10-55-53 for the determination of the measurement model to be applied to an insurance contract, seven relate to the PAA. However, of those seven examples, five are for contracts with a coverage period of one year or less. We do not find these examples particularly helpful, as contracts with coverage periods of one year or less are, by default, accounted for under the PAA. The two PAA examples provided for contracts with coverage periods greater than one year do not adequately explain the concept of significant variability in the expected value of net cash flows.

One of the two PAA examples provided for contracts with coverage periods greater than one year is for a contract surety bond. In this example, a PAA conclusion was reached because the contractor's financial position is stable and the contractor historically completed construction projects on time. A contract duration of three years was assumed. In practice, it is not uncommon for contract surety bonds to extend up to ten years. Based on the implementation guidance provided, it is unclear at what point (i.e. length of contract) a contract has significant variability in the expected value of the net cash flows during the period before a claim is incurred. If, at contract inception, the contractor's financial position is stable and the contractor historically completed construction projects on time, would a five or a seven year contract qualify for PAA? In addition, how should an entity determine the significance threshold? One indicator provided in paragraph 834-10-55-52 is if an entity expects at contract inception that during the contract's coverage period it will significantly change premium pricing for future contracts written with similar or identical risks. However, general economic conditions and market forces often dictate pricing changes, not a re-pricing of risk. Further guidance on this issue would be appreciated.

If the proposed criteria to account for insurance contracts under the PAA are not revised to incorporate all similar contracts, we believe the PAA should be permitted, but not required. Some entities may find it operationally easier to apply the BBA model to all of their contracts, or all contracts for a particular product, rather than to have two different accounting methodologies and we do not believe they should be precluded from doing so if they choose.

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**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?*

**Response 8:** The definition of a portfolio is fundamental to the application of the Proposed Update. The portfolio is the unit of account used to estimate the expected fulfillment cash flows, determine and recognize the margin and acquisition costs, and perform the onerous contract test. The Proposed Update redefines the Portfolio of Insurance Contracts as a group of contracts that (1) are subject to similar risks

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and priced similarly relative to the risk taken on and (2) have similar duration and similar expected patterns of release from risk. Despite the importance of the portfolio concept, we do not believe that the Proposed Update provides sufficient consistent guidance on how preparers should apply the new definition in practice. Specifically, we believe the application guidance in paragraphs 834-10-55-47 through 834-10-55-50 is inconsistent with how we manage our business and with the intent of the Board as expressed in the Basis for Conclusions.

In paragraph BC120 of the Proposed Update, the Board rejected requiring that a portfolio consist of contracts by line of business or product type. The Board concluded that to group contracts by line of business would group contracts at a fairly granular level, which typically would be subsets of contracts with similar risks. In addition, those terms could be interpreted differently in different jurisdictions. This conclusion, however, appears to be inconsistent with the implementation guidance in paragraph 834-10-55-48, which provides factors to consider in determining whether contracts are subject to similar risk, including the type of risk insured, the product line, the type of policyholder, and the geographic location. If an entity is required to consider all of these factors, it may result in very granular definitions of portfolios. This would have adverse implications from the perspective of operational complexity and the required assessment of onerous contracts. Increased disaggregation of portfolios will increase the likelihood that onerous contract portfolios will be identified, which could lead to a change in the earnings pattern recognition (i.e., losses on certain portfolios would be recorded up front followed by gains on the remaining portfolios thereafter) and a reduced ability to compare performance over time and between insurers. We recognize that total income over the entire life of a contract (or group of contracts) will not change; however, periodic results may exhibit substantially more accounting-driven volatility.

In addition, paragraph 834-10-55-50 of the Proposed Update provides an example of determining the appropriate portfolio grouping level. Given the requirement for the margin to be determined at inception and to use locked-in interest rates from contract inception, we believe that a portfolio can only comprise contracts written within the same reporting period (e.g., quarterly). However, the example suggests that contracts that have similar durations can be grouped together into a portfolio if the patterns of release from risk are similar, even if the contracts are written in different reporting periods. The example does not explain how the insurance liabilities, including margin, would be accreted at the required inception date discount rates for contracts so grouped that began in different periods.

We believe that the Board should set forth principles for determining portfolios; for example, to (1) prevent the combination of contracts that have significantly different expected loss ratios and, thus, delay recognition of losses, and (2) recognize revenue, from the margin, consistently regardless of whether contracts are combined or earned separately. The Board should avoid providing further rules around these principles which may only serve to confuse the intended purpose. As the concept of the portfolio applies to discounting, we believe that the interest accretion rate needs to be determined at a sub-portfolio level, defined as the portfolio of contracts entered into during a specified period of time – e.g. the contracts within a portfolio written in a particular quarter.

Finally, the definition of portfolio within the Proposed Update is different from the proposed definition of portfolio within the IASB ED, and it is unclear whether the Boards intend for the definitions to be applied differently in practice. We would encourage the Boards to converge on the definition and/or principles of the portfolio, as it is a main driver for recognition and measurement under the proposed guidance and divergence on this issue will place an operational burden on companies filing under both U.S. GAAP and IFRS.

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**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?*

**Response 9:** The contract boundary is an important concept within the Proposed Update, as it establishes the date of initial recognition of a contract and influences whether the contract would qualify for the PAA. We appreciate that the Board has amended the guidance proposed in the Board's 2010 Discussion Paper, *Preliminary Views on Insurance Contracts* (2010 DP), which required initial recognition of the contract at the contract binding date. However, we feel that the Board should go further and eliminate the necessity to track contracts in the pre-coverage period altogether.

Currently, insurers do not have the systems or processes in place to capture and recognize data as of the contract binding date, which would be required under the proposed guidance for evaluating potential onerous contracts in the pre-coverage period. Insurers would incur significant costs to modify systems and make process changes in order to account for the proposed recognition for seemingly minimal to no benefit. We understand that the intent of this guidance is to immediately recognize losses for potential onerous contracts; however, these circumstances would be extremely rare as insurers do not knowingly enter into unprofitable contracts. Based on our experience that these types of contracts would occur extremely infrequently, if at all, and the precoverage period is typically a relatively short period as compared with the total contract boundary period, we do not believe that the incremental benefit of recognizing an onerous contract in the pre-coverage period outweighs the costs and complexities associated with tracking contracts during that period, especially.

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### **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?*

**Response 10:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we generally 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. We do note, however, that the FASB and the IASB are not converged on this topic insofar as acquisition costs are included in the measurement of the fulfillment cash flows in the IASB ED and are included in the measurement of the margin in the Proposed Update. We understand the Board's concern that acquisition costs are not related to the entity's obligation to the policyholder, but we do not believe this concern should be a sufficient cause for difference. We encourage the Boards to converge on the types of cash flows that would be included in the measurement of the fulfillment cash flows, given the fundamental importance of fulfillment cash flows to both the PAA and BBA.

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**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?*

**Response 11:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we agree that the assumptions used in the measurement of the fulfillment cash flows should be updated each reporting period, which is consistent with how we evaluate changes in estimates of premiums and losses (i.e. development) on a period-by-period basis today.

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**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?*

**Response 12:** We strongly disagree that the fulfillment cash flows for all contracts measured using the BBA and the liability for incurred claims for contracts measured using the PAA should be based on an explicit, unbiased, and probability-weighted estimate 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.

The application of this expected value approach to P&C contracts accounted for under the PAA or the BBA represents a significant departure from the deterministic actuarial reserve measurement approach currently in use. Under the current accounting standards, carried reserves reflect MBE of the unpaid claim and claim adjustment expense liabilities of the company. For P&C companies, MBE is typically based on the ACE which is defined in ASOP 43 as "an estimate that represents an expected value over the range of reasonably possible outcomes." The detailed analyses performed use a variety of accepted actuarial methods and techniques to produce a number of estimates of ultimate loss. Our actuaries determine a point estimate, the ACE, of ultimate loss by reviewing the various reserve estimates and judgmentally assigning weight to each estimate given the characteristics of the product being reviewed. As this process may not include all conceivable outcomes, it produces a conceptual mean rather than an unbiased, probability-weighted statistical mean. There is no current requirement (or recommendation) for the utilization of probability distributions to calculate the ACE. In practice, most actuarial reserve analyses do not create explicit probability distributions. To force the creation of a distribution of outcomes and of payment patterns or cash flows would imply a level of sophistication and certainty that does not exist in the process. This could create a false impression of the ability of actuaries to quantify the uncertainty inherent in any reserve estimate.

Each quarter, the ACE, in conjunction with the results of the detailed reserve reviews, is discussed with our senior management to determine management's best estimate of reserves. This group considers many factors in making this decision. The factors include, but are not limited to, the historical pattern and volatility of the actuarial indications, the sensitivity of the actuarial indications to changes in paid and incurred loss patterns, the consistency of claims handling processes, the consistency of case reserving practices, changes in our pricing and underwriting, pricing and underwriting trends in the insurance

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market, and legal, judicial, social and economic trends. Our recorded reserves reflect our best estimate as of a particular point in time based upon known facts, consideration of the factors cited above, and our judgment. The carried reserve may differ from the ACE as the result of our consideration of the factors noted above as well as the potential volatility of the projections associated with the specific product being analyzed and other factors impacting claims costs that may not be quantifiable through traditional actuarial analysis. However, the carried reserve is still within the range of reasonably possible outcomes as determined by the actuaries. This process results in MBE.

The removal of management judgment from the reserve estimation process would generally result in a reduction in nominal loss reserves and increased volatility in earnings. We do not believe this outcome would be in the best interest of users of the financial statements or policyholders to the extent that it adversely impacts the insurer's solvency.

Without full stochastic modeling, which is costly and not always practical or prudent, we believe the expected value approach outlined in the Proposed Update suggests a level of certainty in the model that should not be reasonably relied upon. We believe the final guidance should set forth a broader principle and allow the actuarial profession to set the standards on how that principle will be met. Specifically, rather than "unbiased, probability-weighted estimate of future cash flows," we suggest that:

*Fulfillment cash flows comprise the present value [if discounting is required] of an estimate that represents the expected value of future cash flows over a range of reasonably possible outcomes. The measurement objective of the expected value is to determine a reserve amount that is adequate, but not excessive, to pay future obligations.*

We do not believe that preparers should be restricted in their approaches and we do not believe accounting standards should govern the actuarial profession or how actuarial estimates are derived. We believe the two-model approach proposed by the FASB provides the required flexibility to differentiate between appropriate expected value calculation approaches for both the PAA and the BBA models. In addition, we believe that management is ultimately responsible for the appropriateness of the estimates recorded in the financial statements; therefore, management should have the latitude to adjust the ACE reserve estimate, if deemed appropriate.

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**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?*

**Response 13:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we generally agree with recognizing 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, and we appreciate the Board's desire to create a more practicable solution to the recognition of the margin and subsequent changes in estimates of future cash flows. Specifically, for contracts accounted for under the PAA, we agree that these changes should be recorded directly in net income. In addition, for contracts accounted for under the BBA, we support the "locked-in" margin approach. We believe that recognizing the changes in expected cash flows in net income as they occur would be more explainable to users and would not skew future results, thus providing increased transparency on a "real-time" basis.

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### **Discount Rates and Discounting**

**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?*

**Response 14:** As mentioned in the cover letter and further discussed in the following questions, while we acknowledge the theoretical merits of discounting, with respect to the P&C industry, we do not believe that the significant complexity introduced by discounting is supported by improved decision-useful information. With the exception of reserves that are fixed and reliably estimable, the introduction of discounting is inconsistent with how we manage our business. Underwriting performance is typically measured internally and analyzed externally on a nominal basis. This is the same basis upon which the claims are settled (i.e., on a nominal versus a discounted basis).

Notwithstanding our comment above, if the Board finalizes the guidance as proposed, we generally agree that it would be appropriate to use rates that reflect the characteristics of the insurance contract liability and not those of the assets backing that liability. However, the Proposed Update acknowledges that discount rates may not be observable in the market. In addition, it is unclear how the Board expects constituents to interpret “the characteristics of the liability.” We feel that the determination of the discount rate should explicitly include, but not be limited to, consideration of the liability’s liquidity and currency risk. Given these complexities, as a practical solution to improve comparability among insurers, we suggest that the Board propose that non-linked contracts (i.e. non-participating contracts) be discounted using a high quality corporate bond rate, similar to the requirement of ASC 715.

In addition, it is unclear to us how the definition of portfolio will impact the determination of the discount rate and vice versa. As previously mentioned in our cover letter, as well as our response to Question 8, the FASB ED’s implementation guidance provides an example of determining the appropriate portfolio grouping level. Given that discount rates are determined on a contract-by-contract basis, it is unclear how contracts entered into in different periods could be included within the same portfolio. However, the example suggests that contracts that have similar durations can be grouped together into a portfolio if the patterns of release from risk are similar, even if the contracts are written in different reporting periods. The example does not explain how the insurance liabilities, including margin, would be accreted at the required inception date discount rates for contracts so grouped that began in different periods.

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**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?*

**Response 15:** Consistent with the discussion in our cover letter, as well as our response to Question 14, we acknowledge the theoretical purity of discounting to reflect the time value of money; however, we strongly disagree with the Board’s proposal to discount the liability for incurred claims under the PAA.

With respect to the P&C industry, we do not believe that significant complexity introduced by this requirement is supported by improved decision-useful information. With the exception of reserves that are

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fixed and reliably estimable, the introduction of discounting is inconsistent with how we manage our business. Underwriting performance is typically measured internally and analyzed externally on a nominal basis. This is the same basis upon which the claims are settled (i.e., on a nominal versus a discounted basis).

As discussed in our response to Question 12, there is inherent uncertainty involved in the estimation of the ultimate loss reserves on a nominal basis. Uncertainty also exists, to an even greater extent, in estimating the timing of the payment of losses and all of the other contract fulfillment elements. A liability accounting measure that is based on measuring cash flows rather than the ultimate liability introduces more judgment, subjectivity, and variation. While true for all policies, this issue is compounded for longer-tail exposures, such as workers compensation and asbestos and environmental pollution liabilities.

The requirement to discount loss reserves will introduce significant accounting-driven volatility into the income statement. Accounting-driven volatility will arise in situations where the total nominal loss reserves are not adjusted, but the allocation of those reserves by policy year changes. The re-estimation of loss reserves between policy years, which occurs frequently, would require the application of different yield curves to the loss reserves transferred. Additionally, the re-estimation of loss reserves between expected payment dates would require the application of different points on the same yield curve for income statement measurement. The net impact on a present value basis will be reflected in the income statement as underwriting income or loss. The interest expense would also be impacted on a go-forward basis due to changes in accretion rates. We do not believe this volatility, which would need to be explained by management, is meaningful to users.

We understand that current U.S. GAAP guidance produces a mixed-attribute accounting model with most investment assets being measured at fair value and P&C insurance contract liabilities being measured on a nominal basis. However, this should not be a cause for concern. As noted above and throughout this comment letter, the current accounting model is well understood by users as they evaluate the insurer's performance and provides decision-useful information. The measurement of investment assets is consistent with other industries, while the measurement of P&C loss reserves on a nominal basis reflects the manner in which we manage our business.

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 addition they typically apply a different multiplier on each profit stream (higher for underwriting and lower for investing) to determine their enterprise valuations. The Proposed Update would integrate investing activities into the underwriting model which will likely cause investors to back out the impacts of discounting to get back to reserves on a nominal basis.

Under the Proposed Update, insurers will be required to select and retain a yield curve for each insurance contract or group of contracts, which would serve as the interest accretion rate for the interest expense calculation and as the reference point for recognizing changes to fulfillment cash flows due to changes in the discount rates in OCI. The guidance provided in the Proposed Update is not clear as to how this requirement should be implemented. Specifically, it is unclear to us how the definition of portfolio will impact the determination of the discount rate and vice versa. As previously mentioned in our cover letter, as well as our responses to Questions 8 and 14, the FASB ED's implementation guidance provides an example of determining the appropriate portfolio grouping level. Given that discount rates are determined on a contract-by-contract basis, it is unclear how contracts entered into in different periods could be included within the same portfolio. However, the example suggests that contracts that have similar

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durations can be grouped together into a portfolio if the patterns of release from risk are similar, even if the contracts are written in different reporting periods. The example does not explain how the insurance liabilities, including margin, would be accreted at the required inception date discount rates for contracts so grouped that began in different periods.

Finally, requiring the determination of interest accretion rates based on the initial rates when the portfolio of contracts is recognized (i.e. on an underwriting-year basis) will create a considerable operational burden on P&C insurers, as all payment pattern data is currently maintained on an accident-year basis. Significant systems changes will need to be made in order to comply with this guidance. However, we understand that discounting based on rates when the claim is incurred may also introduce complexity. We feel that either scenario will introduce an undue burden on P&C insurers, and therefore further demonstrates why the costs and complexities introduced by discounting under the PAA outweigh any potential benefits.

Notwithstanding our comments above, should the Board decide to move forward with the requirement for discounting under the PAA, we 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, and we appreciate the Board's attempt to provide some relief to this otherwise onerous requirement through this practical expedient. However, it is unlikely that we would avail ourselves of the practical expedient given the additional operational challenges it would pose to track and account for contracts that qualify for this expedient separately from those that do not.

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**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.*

**Response 16:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board decide to move forward with the requirement for discounting under the PAA, to the extent that fluctuations in the measurement of the liability are caused by changes in discount rates, these fluctuations should be reported through OCI in order to avoid significant volatility in the income statement. Changes in the discount rate are not reflective of the insurer's performance; therefore, these fluctuations should be reported through OCI. However, we acknowledge that it may not be possible to eliminate all volatility in the income statement, given the proposals currently being deliberated related to financial instruments.

We appreciate the Board's effort to mitigate the impact of short-term interest rate fluctuations on the income statement through the use of OCI for changes in fulfillment cash flows resulting from changes in discount rates. However, we acknowledge that the proposed OCI treatment would introduce significant reporting complexity for P&C insurers. The OCI reporting requirement applies to claim reserves which include IBNR reserves which are typically not estimated at a policy level as well as reserves related to events that have not yet occurred as determined under the onerous contract provisions. We urge the Board to consider the significant costs required for insurers to modify their claim reporting systems to accommodate the new requirements when weighing the cost-benefit of the concept of discounting under the PAA overall.

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**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?*

**Response 17:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board decide to move forward with the requirement for discounting under the PAA, we do not believe that a test should be required to trigger recognition in net income of some or all of the amounts in accumulated other comprehensive income (AOCI), as we believe amounts recognized in AOCI naturally unwind as the liability is extinguished through payment or changes in estimates.

Specifically for P&C contracts, we may not have explicit matching of assets and liabilities. As such, a requirement to track assets in line with liabilities would significantly increase complexity, and we do not foresee this providing additional decision-useful information.

In addition, we do not feel that a loss recognition test in the event that asset returns are lower than expected provides useful information. This may introduce potentially misleading information because the assets are independent of the insurance contracts, and the performance of those assets should not be considered in deciding whether a loss that should be recognized in profit or loss has occurred.

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**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?*

**Response 18:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board decide to move forward with the requirement for discounting under the PAA, we appreciate the Board's flexibility in the determination of the discount rate. However, we believe that methods such as the top-down and bottom-up approaches introduce further complexity into an already complex general requirement to discount and may hinder comparability among insurers.

With respect to the bottom-up approach, which would likely be used by P&C companies due to the fact that assets and liabilities may not be explicitly matched, the calculation of an illiquidity premium, which is not market observable, could produce application inconsistencies that may not be overcome through expanded disclosure. We therefore suggest, as a practical solution to improve comparability among insurers, that the Board propose that non-linked contracts (i.e. non-participating contracts) be discounted using a high quality corporate bond rate, similar to the requirement of ASC 715.

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**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?*

**Response 19:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board decide to move forward with the requirement for discounting under the PAA, we generally agree that interest expense should be based on the discount rates determined at the date the portfolio of contracts was initially recognized. However, the way the Proposed Update is drafted, it is not clear how the discounting requirements are impacted by the definition of a portfolio.

Paragraph 834-10-55-50 of the Proposed Update suggests that contracts that have similar durations can be grouped together into a portfolio if the patterns of release from risk are similar, even if the contracts are written in different reporting periods. The example does not explain how the insurance liabilities, including margin, would be accreted at the required inception date discount rates for contracts so grouped that began in different periods. As such, further guidance in this area would be appreciated.

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**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?*

**Response 20:** Despite the complexity of the Board's proposal in this area, we agree that resetting interest accretion rates to rates that reflect estimated remaining interest expense is necessary because it ensures that total interest expense over the life of the contract is accurately portrayed, even though it may not resolve all mismatch possibilities.

Specifically, because some movements in interest rates affect the cash flows of asset-affected contracts, presenting interest expense based on rates locked in at inception of those contracts would be inconsistent with the variable rate nature of the amounts borrowed by the insurer under the contract. In addition, because payments vary with changes in interest rates, portraying the interest expense as if it resulted from fixed-rate financing would be inconsistent with the objective of recognizing in OCI changes that reverse when the contract is settled. Finally, the degree to which entities adjust the locked-in rates should be reflective of the extent of change in amounts expected to be paid to the policyholder as interest, and should exclude any changes in cash flows attributable to underwriting activity.

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**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?*

**Response 21:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we agree that an insurer should not recognize a gain at initial recognition of an insurance contract, but, rather, should defer that amount as profit to be recognized in the future.

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**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.*

**Response 22:** Under the BBA, we support using a one-margin approach, as included in the Proposed Update, rather than an explicit risk adjustment and contractual service margin. We appreciate the Board's desire to create a more practicable solution for recognition of the margin, as the composite margin is easier to calculate and more comparable across companies.

We specifically disagree with the IASB's proposal, as we believe the estimate of net cash flows should not include a risk adjustment margin due to the complexities involved in determining an appropriate risk adjustment and the inability to properly define and measure risk with a single number.

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**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?*

**Response 23:** Per our response to Question 22, we do not support a risk adjustment and a contractual service margin.

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**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?*

**Response 24:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we agree that a loss at initial recognition of a portfolio of insurance contracts should be recognized immediately in net income.

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However, as discussed further in our cover letter and our response to Question 8, we are concerned that if an insurer considers all of the factors discussed in the implementation guidance in paragraph 834-10-55-48, it may result in very granular definitions of portfolios. This would have adverse implications from the perspective of operational complexity and the required assessment of onerous contracts. Increased disaggregation of portfolios will increase the likelihood that onerous contract portfolios will be identified, which could lead to a change in the earnings pattern recognition (i.e., losses on certain portfolios would be recorded up front followed by gains on the remaining portfolios thereafter) and a reduced ability to compare performance over time and between insurers. We recognize that total income over the entire life of a contract (or group of contracts) will not change; however, periodic results may exhibit substantially more accounting-driven volatility.

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**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?*

**Response 25:** As proposed, it is unclear whether the complexity introduced by the requirement to recognize the margin as we are released from risk under the insurance contracts provides additional decision-useful information to users. Because there is no objective, consistent approach for measuring risk, and the Board does not provide a specific methodology for doing so, differences in application will result. As such, we request that the Board provide additional implementation guidance on this issue.

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

**Response 26:** We disagree with the Board's proposal that interest should be accreted on the margin and therefore affect insurance contract revenue. Rather, we support the Board's proposal in the 2010 DP to not accrete interest on the margin, as the accretion of interest represents an artificial gross-up of the income statement and adds complexity and operational challenges without providing additional decision-useful information.

Furthermore, we believe that the accretion of interest on the margin would represent a double-counting of the unwinding of the discount on the expected cash inflows and expected cash outflows. As the discounting of the expected cash inflows and expected cash outflows unwinds, the differential represents a net impact to earnings and is representative of the interest accretion on the margin.

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**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?*

**Response 27:** For contracts accounted for under the BBA, we agree in principle that once a contract is onerous, an entity should recognize the remaining margin immediately in net income. However, we do not believe that the guidance, which predominately discusses onerous contracts in the context of the PAA, adequately articulates how this requirement would be applied.

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In paragraph BC330, the Board notes that a portfolio of contracts would be expected to generate a loss if the present value of payments for benefits and related settlement and maintenance costs exceeds the present value of gross premiums. When read in conjunction with paragraph 834-10-35-22, a reporting entity may conclude that it should only consider expected cash flows. However, this interpretation does not appear to be appropriate, as contracts that require payment of premium upfront would be onerous upon receipt of the premium, as future expected cash outflows would exceed future cash inflows. Assuming the reporting entity is not limited to consideration of future cash flows, it is unclear if the assessment of whether a portfolio of contracts would be expected to generate a loss should be based over the entire life of the portfolio or the remaining life of the portfolio. The latter interpretation would be more consistent with the onerous contract assessment under the PAA; however, it would require separate tracking of unrecognized insurance contract revenue derived from fulfillment cash flows. Due to the lack of clarity in this area, we would appreciate additional implementation guidance specific to recognition of onerous contracts under the BBA.

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### **Acquisition Costs**

**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?*

**Response 28:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we agree that the direct acquisition costs presented with the margin should include only those costs directly related to the entity's selling efforts that result in obtaining the contracts in the portfolio, and all other costs should be expensed as incurred. ASU 2010-26, *Financial Services—Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts* (ASU 2010-26), became effective in the first quarter of 2012 and clarified what costs should be deferred (deferred acquisition costs or DAC) by insurance companies when issuing or renewing insurance contracts. The guidance in ASU 2010-26 resulted in insurers making significant systems changes to comply with the new requirements. With the exception of direct response advertising, the guidance regarding qualifying acquisition costs in the Proposed Update is consistent with the guidance in ASU 2010-26. To broaden the requirements for qualifying acquisition costs, as proposed by the IASB, would require additional systems changes and would put a financial and human resource burden on companies that just went through a similar implementation two years ago.

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**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?*

**Response 29:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we agree that the measurement of the margin for contracts measured using the BBA and the liability for remaining coverage for contracts measured using the PAA should be reduced for direct acquisition costs incurred. Specifically, we agree

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that the margin and liability for remaining coverage should be reduced when acquisition costs are incurred, as it represents a reduction in the expected profit that will be earned over time.

Although the net impact on the FASB composite margin and the IASB residual service margin is similar, we do note that the FASB and the IASB are not converged on this topic, insofar as acquisition costs are included in the measurement of the fulfillment cash flows in the IASB ED and are included in the measurement of the margin in the Proposed Update. We understand the Board's concern that acquisition costs are not related to the entity's obligation to the policyholder, but we do not believe this concern should be a sufficient cause for difference. We would encourage the Boards to converge on the types of cash flows that would be included in the measurement of the fulfillment cash flows, given the fundamental importance of fulfillment cash flows to both the PAA and BBA.

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**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?*

**Response 30:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we generally agree with recognizing acquisition costs as an expense in net income in the same pattern of recognition of the margin under the BBA. However, we anticipate that the proposed recognition pattern under the PAA will introduce significant complexity, as these costs are generally recognized on a straight-line basis for short-term contracts today. It is unclear what incremental benefit the added complexity will provide to users.

For the majority of our P&C contracts, we believe that straight-line recognition would still be appropriate under the proposed guidance (i.e. the pattern of release from risk is on a straight line basis). However, for catastrophe coverage, the amortization of qualifying acquisition costs under the Proposed Update will likely not equal the amortization of DAC under today's guidance on a straight-line basis. We do not feel that the added complexity of determining release from risk for catastrophes provides significant additional decision-usefulness to users.

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**Insurance Contract Revenue**

**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?*

**Response 31:** We agree that it is more appropriate to present insurance contract revenue and incurred expenses, rather than only information about changes in margins (that is, the net profit). We feel that showing just the net effect (i.e. margin only) would not allow effective use of profitability metrics and loss ratios used to manage the business. However, we have concerns with the application of the insurance contract revenue concept for long term insurance contracts. We do not believe this measure, as currently proposed, provides useful and meaningful information about portfolios of long term insurance contracts, particularly when the complexity of applying these proposals is taken into account. We do not believe that

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users are seeking, or the Board will achieve, true comparability between revenue defined for the insurance industry and revenue reported by other industries. It is highly likely that both during and after implementation of any new insurance accounting standard, traditional measures of premiums and claims will remain a focus for many preparers and users of financial statements. As such, we believe the Board should look to provide specific disclosure requirements around such traditional measures. While doing so may be inconsistent with the Board's view on revenue presentation, we believe that it would be beneficial in order to avoid such information becoming a prominent non-GAAP measure, which would consequently be open to considerable inconsistency of presentation.

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**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.*

**Response 32:** While we agree in theory with the exclusion of estimated returnable amounts from revenue, as they represent amounts repayable to the policyholder rather than new contracts, it is unclear, as drafted, how the Board intends the proposed guidance to be applied.

Specifically, it is unclear how the example in paragraphs 834-10-55-160 and 55-161 provides decision-useful information when claim amounts are paid as losses but are recorded as estimated returnable amounts, similar to those policies that do not have any losses. For instance, we feel the payment of a no-claims bonus represents a different economic scenario than paying out a claim (i.e. return of premium rather than payment of loss), but under the proposed guidance the accounting would be similar. Clarification of whether the Board views these as economically similar transactions would be appreciated. We view these scenarios as economically different and, as such, different accounting treatment should apply.

Additionally, it is unclear how dividend policies would be treated. For some contracts, we issue dividends based on experience of the policy. We believe these policies would be treated similar to retro policies or premium audits today, in which case the estimated returnable amount (i.e. the dividend), would reduce premium revenue. This appears consistent with the proposed guidance, but additional implementation guidance would be helpful.

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**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?*

**Response 33:** While we acknowledge the theoretical merits of reflecting the time value of money within the measurement of assets and liabilities, we disagree with the incorporation of time value of money in the measurement of the liability for remaining coverage. As discussed further in our responses to

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Questions 14 and 15, we do not believe that the additional complexity introduced by this requirement is supported by improved decision-useful information.

We appreciate the Board providing the practical expedient; however, we do not believe that the additional complexity introduced by this requirement is supported by improved decision-useful information, as it simply represents a gross-up on the income statement. Specifically, the income statement will present a gross-up between insurance contract revenue and interest expense, and will result in redistribution of income between underwriting activities and investing activities. Although we currently do not have a significant number of policies that would fall outside the practical expedient, changing economic conditions may result in more P&C contracts being structured over a period longer than 12 months.

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**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.*

**Response 34:** We do not feel that sufficient guidance is provided to determine insurance contract revenue under the BBA. Specifically, the Board does not prescribe a specific release pattern for the margin, but rather offers principles-based guidance. While the FASB rejected the IASB's explicit risk adjustment in part because there was no objective, consistent approach for measuring risk, it seems that the FASB's proposal for recognizing revenue based on the pattern of release from risk may suffer from the same imperfection in measurement due to the lack of any specified methodology for measuring the release from risk. Where explicit guidance is not provided, it will create diversity in practice and comparability issues among companies. As such, additional implementation guidance in this area would be appreciated.

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**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?*

**Response 35:** We appreciate that the Board has attempted to identify a solution for accounting mismatches in products that are linked. However, in practice, it will be difficult to segregate cash flows related specifically to contracts that are linked. We do not feel that the mirroring concept aligns with the Board's objective to simplify insurance contract accounting. Although there are only "two models" for insurance contract accounting (the BBA and PAA), the guidance related to participating contracts represents a departure from the main principles of the BBA, which complicates the operability of the Proposed Update as a whole.

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The proposed guidance introduces operational complexity by requiring entities to decompose contracts into cash flows that are expected to vary directly, indirectly, or not at all with the returns on underlying items. The complexity then increases when the underlying items of a contract or a portfolio of contracts are accounted for using a mix of measurement attributes, such as amortized cost, fair value through OCI, or fair value through net income. The intricacies in this accounting would necessitate entities to track data at a more granular level and incorporate further linkages in their asset management and liability systems, not to mention other special cases that include segregated funds and discretionary crediting rates. Notwithstanding these comments, we agree in theory with the requirement to reset the discount rate used to measure the insurance contract liability for insurance contracts with discretionary participation features in order to decrease volatility.

We encourage the Boards to reconsider the appropriateness of the model proposed and to examine whether the detailed requirements should be revised so as to make the approach clearly understood, meaningful in outcome, and capable of consistent application. The Board should consider if an alternative solution may be possible that is conceptually closer to the BBA and more obviously capable of consistent application. If the Boards pursue this guidance further, we encourage the FASB and IASB to work toward convergence on this issue, as the differences in proposed guidance between the FASB and IASB could have significant implications on companies that file under both U.S. GAAP and IFRS.

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**Reinsurance**

**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?*

**Response 36:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we 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 for (a) retrospective reinsurance contracts accounted for using either the BBA or the PAA and (b) prospective reinsurance contracts accounted for using the BBA.

However, we do not agree with the proposed change in guidance concerning the accounting for ceding commissions. The Proposed Update requires that ceding commissions paid to the cedant that are not loss sensitive be treated as a reduction in premiums paid by the cedant. Under current U.S. GAAP, ceding commissions represent recovery of acquisition costs that reduce capitalized acquisition costs. We believe that current U.S. GAAP is a better reflection of the economics of the transaction. From a presentation perspective, it makes sense for the insurance and reinsurance premiums to mirror each other. Under the Proposed Update, for a contract that was 100% reinsured, netting the ceding commissions with the reinsurance premium would result in a residual net premium being presented in the income statement.

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**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?*

**Response 37:** Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board move forward with the proposed guidance, we agree that there should be symmetry between the recognition and measurement of reinsurance contracts and the underlying ceded contract. In the absence of such symmetry, as is the case in the IASB ED, there may be situations in which a reinsurance contract is accounted for using the BBA and the underlying contract is accounted for using the PAA. This may result in a reinsurance receivable balance being recognized prior to the recognition of the related reserves on the underlying ceded contract. This outcome would provide non decision-useful information and would add to confusion and complexity in the industry.

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**Insurance Contracts Acquired in a Business Combination**

**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?*

**Response 38:** Where possible, we generally believe that it would be most appropriate to adhere to the principles in ASC 805, *Business Combinations*, rather than set forth additional industry-specific guidance, which is a direct contradiction to the FASB's stated objective to minimize industry-specific guidance related to insurance contract accounting.

Notwithstanding our general concerns with the Board's proposed changes related to P&C contracts, should the Board proceed with creating industry-specific guidance for insurance contracts as proposed, we think an entity should instead increase goodwill 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. The FASB's proposal to record an immediate loss in a business combination seems contrary to other U.S. GAAP that recognizes that transactions executed at arm's length typically do not result in an immediate loss.

We encourage the Boards to converge on the accounting for insurance contracts acquired in a business combination, as divergence on this issue will place an operational burden, along with significant costs for companies filing under both U.S. GAAP and IFRS.

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**Contract Modifications**

**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?*

**Response 39:** Notwithstanding our general disagreement with the Proposed Update as it relates to P&C contracts, we generally agree with the Board's proposals regarding recognition of contract modifications. However, the application guidance appears unclear, specifically with respect to what changes would be considered "substantial." A literal interpretation of paragraph 834-10-55-170(c) could lead a reader to believe that any change in these components would be considered substantial. As such, implementation of the proposed guidance will be mechanically difficult without additional guidance or definition of a "substantial change."

In addition, the proposed guidance may not be operational because the unit of account for contract modifications is at the contract level, which is a lower unit of account than cash flows are maintained (i.e. at portfolio level). To derecognize a single contract implies that modifications and cash flows are tracked at a contract level rather than portfolio level. Additional guidance is needed to clarify how the Board intends for this requirement to be applied.

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**Presentation**

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

**Response 40:** We generally do not agree with the presentation requirements included in the Proposed Update. Specifically, because an insurer would not be allowed to aggregate portfolios in a net asset position with those in a net liability position and balances relating to the PAA and BBA must be presented separately, we feel the proposed presentation is too detailed and may clutter the balance sheet, especially if an entity has insurance and reinsurance contracts under both models, as well as non-insurance operations. We also believe the proposed segregation of portfolios in a net asset position from those in a net liability position will add to the complexity of preparing and reviewing the financial information. In our opinion, the FASB's proposal could be simplified by requiring a level of presentation more akin to the IASB ED, which allows one line for insurance contract assets and one line for insurance contract liabilities without distinguishing between the BBA and the PAA measurement models.

As proposed, the requirements represent a significant change from how results are presented and understood today. The proposed presentation changes will significantly impact the way management, analysts, and investors review financial statements, and they will need to be educated on the new presentation format, along with the impact of the approach on reported earnings and key performance indicators, such as loss ratios. Moreover, the proposed presentation requirements do not meet the Board's objective of decreasing barriers of entry for professionals analyzing and investing in the insurance industry; rather, we feel the proposed requirements would increase these barriers.

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With respect to qualifying acquisition costs, we support the measurement of the margin for contracts measured using the BBA and the liability for remaining coverage for contracts measured using the PAA being reduced for direct acquisition costs incurred. However, we believe that this results in a lack of symmetry between the income statement and balance sheet. This is an unnecessary complication and does not provide decision-useful information. In addition, the Board provides a practical expedient under the PAA to expense all qualifying acquisition costs as incurred, leading to recognition of these expenses within "other insurance expenses." It would be more appropriate to present amortization and/or expense of qualifying acquisition costs consistently.

Similar to our comments above on the balance sheet, we believe the proposed guidance for income statement presentation is too detailed and may clutter the income statement. We prefer the IASB's proposed statement of comprehensive income presentation, which is more streamlined.

We agree that the presentation of underwriting results separate from investment results provides decision-useful information; however, it is not necessary to separately present the components of underwriting results by model type on the face of the financial statements. We recommend and encourage the Board to conduct substantial field testing of presentation requirements to confirm whether the proposals provide more than incremental decision-useful information to the investor/user community.

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**Disclosure**

**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?*

**Response 41:** We generally disagree with the volume and level of the disclosure requirements included in the Proposed Update. As proposed, the disclosure requirements are more detailed than current guidance and will require significant investment in systems and processes in order for our systems to capture and produce the relevant information to reconcile changes in our insurance and reinsurance balances.

The voluminous nature of these disclosures will be overwhelming to users and difficult to understand and interpret. In addition, the proposed disclosures will increase pressure on already tight reporting deadlines. Specifically, the proposed requirement that disclosures be reported at no higher than the segment level creates overly granular disclosures that will not provide additional decision-useful information.

Regarding specific aspects of the proposed disclosure requirements, we are concerned with the required disclosure of fulfillment cash flows grouped in prescribed time bands, and, for each time band, the corresponding weighted-average interest accretion rates and the weighted average current discount rates. Weighted-average interest accretion rates by time band become less meaningful as contracts from different economic cycles are grouped into the same time band. Therefore, the weighted-average accretion rate disclosed will not be comparable across entities with insurance contract liabilities that originated in different periods, as this will distort the weighted-average nature of the calculation. Should the Board continue to pursue this type of disclosure, we believe that disclosing quantified ranges would be more appropriate.

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We are also concerned with the proposed requirement to reconcile the disclosure of the undiscounted amount of claims on an accident year basis with the carrying amount of the insurance contract liabilities in the statement of financial position. This reconciliation will be complicated by the different measurement bases (i.e. discounted vs. undiscounted) and also by the fact that insurance contract liabilities are recorded in the liability for incurred claims for contracts measured under the PAA model and insurance contract asset/liability, which itself is a net balance, for contracts measured under the BBA model. This complexity will limit the decision-usefulness of the information for users of the financial statements. In addition, we believe that users will focus primarily on the undiscounted amount of the claims on an accident year basis, rather than the discounted carrying amount.

Finally, we believe the required sensitivity analyses will produce numerous pages of additional disclosure information that is highly judgmental and does not provide incremental decision-usefulness to users. These disclosures would be required at the same level at which the entity disaggregates its reconciliation of the insurance contract liabilities or assets, thereby establishing a potential for significant volume of disclosures related to the sensitivity analyses. The amount of information could result in more confusion than clarity and diminish the usefulness of true operating results, such as favorable or unfavorable loss development. This is a clear departure from the FASB's objective to simplify and improve financial reporting for insurance contracts. Overall, we feel that the sensitivity analyses and related disclosures at this level of detail are not practical.

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**Effective Date and Transition**

***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?*

**Response 42:** The key drivers affecting the timing of implementation include the time required to develop systems and processes to identify and track new data and complete required calculations related to discount rates and onerous contracts in the pre-coverage period, along with the related controls required by Section 404 of the Sarbanes-Oxley Act of 2002 (SOX 404).

Specifically, the majority of insurers do not currently have systems or processes in place designed to capture and recognize data as of the contract binding date. We would incur significant costs to modify systems and make process changes in order to account for the proposed recognition of onerous contracts in the pre-coverage period. We believe losses for potential onerous contracts in the pre-coverage period would be extremely rare as insurers do not knowingly enter into unprofitable contracts. In addition, our actuaries will need to re-evaluate existing processes and methodologies and amend those methods in response to the new guidance.

Furthermore, we would need to evaluate all existing policies in order to appropriately bucket them in portfolios, classify the portfolios as PAA or BBA, and apply the proposed guidance. We currently have over 4 million insurance policies in-force, which will require tremendous time and effort to re-evaluate.

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Additional key drivers include the time required to:

- Reassess reinsurance policies and underlying contracts, and
- Determine appropriate discount rates by period and by policy or portfolio.

Indirect key drivers and impacts include renegotiating impacted debt covenants and employee compensation performance metrics. We must also evaluate the best way to communicate the impact of the new guidance to the investor community as well as internal stakeholders.

Based on the above-mentioned drivers, implementation of the proposed guidance will require a minimum of 3 years to implement and will be extremely costly.

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***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?*

**Response 43:** If finalized as proposed, we believe that the Board should allow a minimum of three years for public companies to implement the proposed guidance, with potential extension of that adoption date in certain cases for non-public entities.

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***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?*

**Response 44:** Notwithstanding our general disagreement with the Proposed Update as it relates to P&C contracts, we generally agree that the practical expedients relating to transition included in the Proposed Update are sufficient for retrospective application.

However, we suggest that the Board offer a practical expedient for determining accretion rates for PAA contracts upon transition. Specifically, we would appreciate if the Board allowed the use of the yield curve as of the transition date, rather than the curve at the contract inception date. We believe that this practical expedient would appropriately balance transition complexity and theoretical purity given the short-term nature of contracts expected to qualify for the PAA.

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***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?*

**Response 45:** We generally believe that it would be most appropriate to adhere to the guidance in ASC 805, rather than set forth additional industry-specific guidance, which is a direct contradiction to the FASB's stated objective to minimize industry-specific guidance related to insurance contract accounting.

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Notwithstanding our comment above, should the Board move forward with the guidance as proposed, we have significant concerns regarding accessibility to adequate data to perform the reallocation of the fair value of the asset and liability balances related to insurance contracts between the expected fulfillment cash flows and the margin as of the date of acquisition, which may have been several years or perhaps decades ago. Similarly, in situations in which we sold a business, either through reinsurance arrangements or sales, we will be forced to rely on the cooperation of the purchasing insurer and the adequacy of their systems, specifically for the restatement of gross liabilities and related reinsurance receivables.

We suggest the Board simplify the transition for prior business combinations by considering the option noted by some Board members in paragraph BC424 of the Proposed Update. This option would allow entities to carry forward the previous intangible asset as the margin, which would reduce complexity in determining the reallocation and would compensate for any comparability issues in the calculation of the intangible asset and the margin.

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**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?*

**Response 46:** Notwithstanding our overall disagreement with the proposed guidance for P&C contracts, including the concerns noted above in terms of time and resource constraints, we feel the proposed approach to transition is appropriate. We do not anticipate the practical expedients offered will compromise the decision-usefulness of the financial statements at time of transition and going forward.

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**Costs and Complexities**

**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.*

**Response 47:** While we support the FASB's objectives of improving and simplifying the financial reporting for insurance contracts and we acknowledge the theoretical merits of several individual aspects of the Proposed Update, we believe that several aspects of the proposed accounting models would require significant changes to systems and processes that are complex and are not consistent with how we manage the business. We therefore expect implementation to be very difficult and costly. Such costs can only be justified if the new accounting model provides financial statement users with significantly improved transparency into the financial performance of the business, the underlying key judgments, and the risks and uncertainties related to those judgments, and we do not believe the proposed guidance accomplishes these objectives.

Furthermore, as an international company with operations subject to U.S. GAAP and IFRS, the cost of implementing the proposed changes to insurance contracts guidance, as issued by the FASB and the IASB, will be significantly higher in the absence of true convergence.

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We anticipate significant one-time initial costs of implementing the guidance if it is finalized as proposed, including a complete system overhaul in order to develop the capability to provide the information required for external reporting purposes as well as management analysis. The key drivers of these costs include:

- Reconfiguration of systems to discount cash flows, estimate probability-weighted cash flows, compute and recognize margins, and apply general ledger mapping.
- Reconfiguration of systems to recognize insurance contracts when bound in order to track pre-coverage period onerous contracts.
- Restoration and analysis of historical data to determine the transition impact.
- Revision to tagging in our eXtensible Business Reporting Language (XBRL) used to communicate financial and business data electronically, as mandated by the SEC.
- Education of preparers and users of the new presentation and disclosure requirements.
- Training of users of the new systems and processes.
- Indirect costs to implement the proposed guidance include updating processes and procedures to ensure compliance with SOX 404, as well as updating all calculations that rely on profitability metrics, such as compensation, covenants, etc.

Beyond the one-time initial costs of implementation, the proposed guidance would require substantial on-going costs. Specifically, our actuarial staff would need to be increased significantly due to the requirement to update assumptions each reporting period. In addition, the proposed guidance will require an additional commitment of time spent with analysts, auditors, and internal stakeholders (including management) to explain accounting-driven volatility in our financial results. Preparation of the overly voluminous disclosures will be burdensome and require additional expenditures of time on the part of our actuaries, accounting, and finance professionals, specifically related to the completion of the sensitivity analyses and updates to assumptions each period.

We feel that the Board's attempt to create a theoretically pure accounting model for insurance contracts drives significant complexity that does not provide additional decision-useful information to users as compared with the guidance today.

Notwithstanding our general disagreement with the proposed changes related to P&C insurance accounting, if the Board moves forward with the guidance as proposed, we feel that the following items would cause us the most concerns:

- The expected value concept within the PAA.
- The requirement to perform full remeasurement each reporting period.
- The rigid requirements for determining different portfolios.
- The voluminous disclosure requirements:

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***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.*

**Response 48:** Not applicable as the question is directed at auditors. See our response to Question 47.