

AMERICAN INTERNATIONAL GROUP, INC.



October 25, 2013

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

**Re: FASB File Reference No. 2013-290, Proposed Accounting Standards Update,
*Insurance Contracts***

American International Group, Inc. (“AIG”, “we”, or “our”) appreciates the opportunity to comment on Proposed Accounting Standards Update, *Insurance Contracts (Topic 834): Insurance Contracts* (the “Exposure Draft” or “ED”). AIG is an international insurance company with diverse product offerings including property/casualty, life, annuities, and mortgage guaranty insurance. We support the Financial Accounting Standards Board’s (the “FASB” or the “Board”) efforts to develop common, high-quality guidance that establishes the principles that an entity would apply in the recognition, measurement, presentation and disclosure of insurance contracts issued and reinsurance contracts held in an entity’s financial statements. We also support enhanced convergence of the FASB’s and the International Accounting Standards Board’s (the “IASB”, collectively the “Boards”) reporting requirements for insurance and reinsurance contracts, although prefer the FASB to, first, provide users with a reliable and user friendly accounting model and, second, work with the IASB to converge to these standards as feasible. While we agree with the FASB’s objective to increase the decision usefulness of the information about an entity’s insurance liabilities and the effect on the statement of comprehensive income and to provide comparability regardless of the type of entity issuing the contract, we believe that the proposed accounting guidance fails to meet this objective with respect to the statement of comprehensive income.

Because the scope of changes to be applied simultaneously is unprecedented and the ED impacts the profit emergence of virtually all insurance products, the proposed changes to insurance accounting will have significant implications to insurers’ business and operations and will be extremely costly to implement. Yet, for several key aspects of the ED as discussed in this letter, there is either no financial reporting benefit or the cost of adopting the change substantially exceeds any perceived financial reporting benefit. To render the new guidance workable as a whole, it is essential to reduce complexity and costs for those areas in which the financial benefit is questionable. If this cannot be accomplished within the developed framework, we believe current generally accepted accounting principles in the United States (“U.S. GAAP”) need not be overhauled completely but merely amended for a few targeted changes. For example, the FASB could simply update ASC Topic 944 as it relates to Statement of Financial Accounting Standards (“FAS”) 60 long-duration and FAS 97 limited pay models for targeted changes relative to current U.S. GAAP or even replace these models with the Building Block Approach (“BBA”), as amended for comments accepted in the FASB’s re-deliberation process. Other insurance models, including FAS 60 short-duration, FAS 97 investment contracts, FAS 97 universal life contracts, and Statement of Position (“SOP”) 03-1 guarantees, could be updated for targeted changes and

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subsequently deliberated for replacement only after the BBA model is fully tested in practice on specified products.

Below is a summary of our general thoughts and concerns regarding the direction of the proposed accounting for insurance contracts and key recommended changes to the ED. Our responses to the specific questions posed in the ED are included in the Appendix to this letter.

General Observations regarding the ED and Insurance Contracts Project

First, we acknowledge and commend the FASB on its thorough review of the current guidance on accounting for insurance contracts under U.S. GAAP. The ED applies sound technical principles and provides logical conclusions and support for most of the positions taken, particularly with respect to the balance sheet. In several instances, the Board has taken positions that reduce operational complexity and cost and/or enhance the decision usefulness of the statement of comprehensive income to financial statement users relative to the IASB, including, but not limited to: i) the exclusion of a risk adjustment in the post-coverage liability of the Premium Allocation Approach (“PAA”); ii) application of a single instead of a dual margin as proposed by the IASB; iii) several practical expedients with respect to transition and other applications of the guidance; and iv) guidance on participating products for which policyholder liabilities are contractually-linked to invested assets. We also agree with many other conclusions in the ED as expressed in the Appendix to this letter. Nevertheless, we have concerns with many important areas of the proposed accounting for insurance contracts as further outlined in this letter.

We believe that certain changes to accounting for insurance contracts, as proposed in the ED, would either render the statement of comprehensive income less decision-useful relative to current U.S. GAAP or create operational complexities for which the benefits to financial reporting do not exceed the costs. Fundamentally, the ED’s conclusions tend to be more weighted toward the balance sheet with the statement of comprehensive income often a consequence of technical conclusions on the balance sheet. This approach differs from current U.S. GAAP that provides greater focus to the unique nature of an insurer’s income statement as a meaningful measure to assess an insurer’s operating performance. For multi-line insurers, users of financial statements typically rely on supplemental information that disaggregates the income statement by product and provides other earnings analyses, such as source of earnings reports or “normalized” earnings reports to facilitate period-to-period comparisons, which can be derived from financial information prepared for current U.S. GAAP. Under the proposed BBA that bundles contractual cash flows into one model, we believe it will be more complicated to derive these types of supplemental information for analysis purposes. While we understand the FASB’s recent guidance has focused on the balance sheet, the importance of U.S. GAAP profit emergence with respect to an insurer’s accounting for its products is of paramount business importance. Because the ED will dictate the basis for U.S. GAAP profit emergence of virtually all products sold by insurance (and other) companies and such decisions are apt to have market consequences, we request the Board considers unique aspects of the insurance industry while re-deliberating earnings emergence as opposed to forcing alignment with other areas of accounting, such as Revenue Recognition. Otherwise, we run the risk of substantially increasing the use of non-GAAP measures which would also increase the cost of adopting this proposal.

Because the changes proposed in the ED require updates or overhauls of financial systems for virtually all insurance products, we view the ED as a business standard with consequences well beyond financial reporting. This proposal will affect all aspects of our business including product decisions, operations, business strategies, capital management, technology, investor relations, producer compensation, and other areas. Further, the increased earnings and equity volatility will result in a higher cost of capital to the industry and potentially lower stock valuations. As such, executing all the required changes to financial

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reporting and business systems simultaneously within a 4-year period as we recommend in this letter, including implementation of international standards that significantly differ from U.S. GAAP and other upcoming accounting changes such as Financial Instruments, will require a substantial work effort and strain for professionals within every aspect of insurance operations. Therefore, we encourage the FASB to fully appreciate the wide scope of the changes to insurance entities in its re-deliberation of the ED by introducing simplifications or practical expedients wherever feasible. In our view, we believe several targeted changes as outlined below could facilitate the implementation of the ED in totality while reducing the very significant aggregate costs to a more manageable level. Many of our recommendations in this letter are made with this thought in mind.

Key Recommended Changes to Improve the Decision Usefulness of the Statement of Comprehensive Income

Examples of areas in which we believe the ED can be improved to ensure earnings emergence is more consistent with business models include:

- Revise the BBA Model to Include “Unlocking” of Margins – We believe the lock-in of the margin liability results in an emergence of profit that is a less relevant measure of company performance than an unlocked margin. While the ED’s basis for conclusion focuses on the relevance of the immediate recognition of all changes in expected cash flows through income in the period in which cash flows are revised, we believe the future profit, as it would emerge under the ED, provides a less meaningful measure of company performance. For example, if a product is originally priced with an expected margin equal to 8% of premium but actual experience reduces the expected margin to 2% of premium, we believe reflection of profit at the 8% margin in future periods is irrelevant when assessing company performance. Instead, reflection of contract profitability based on both actual and expected future cash flows would be the relevant measure. To accomplish this, the margin liability must be unlocked.

We believe changes in expected cash flows should be partially reflected through income and partially as changes to the margin liability in the balance sheet. Changes to future cash flows represent changes between original profit expectations and current profit expectations that should be recognized in the period in which the insurer is released from risk and not before. Accordingly, the margin should be revised retrospectively to reflect a product’s expected profitability based on actual and expected future cash flows and amortized through the balance sheet date. In applying the retrospective method, a portfolio’s margin liability would represent the unearned profit at the reporting date based on current cash flow estimates and expiration of risk through the balance sheet date. While this will create additional operational complexities to measure the margin, we believe the benefit to users of financial statements will exceed the costs. In some respect, the proposed guidance in the ED allows companies to incur a large loss in one period and avoid charges in future periods that the loss is more appropriately allocated to.

Furthermore, we believe the notion that all expected changes in future contractual cash flows must be recognized immediately is inconsistent with a basic tenet of the life and annuity business, which is cash flows are relatively stable in the long-term assuming there is a sufficient population of insureds because of “the law of large numbers”. Short-term fluctuations in assumptions are subject to reversing over time, often resulting in only a small deviation of the ultimate experience relative to expectations. Because of this, recognition of all expected changes to future cash flows in a single quarter would create earnings volatility that is inconsistent with the basic business model. Instead, we believe the effect of changes in cash flows should be reflected over the claims settlement period. To accomplish this, the margin liability must be unlocked.

We believe the following two areas would benefit from this change as well as reduce operational complexity relative to the ED:

- Application of Onerous Contract in the BBA Model -- If the margin is unlocked, it would eliminate the counter-intuitive manner in which a margin liability is eliminated and large gain recognized at the time a portfolio is deemed to be onerous or expected to incur a net loss. In the proposed BBA model, when a portfolio is expected to incur a \$1 loss, the full margin liability held on the portfolio would be reversed, creating a large gain to income. Under unlocking, at the time a portfolio is expected to incur a net loss, the margin liability would have previously been reduced as expected profits deteriorated, thereby eliminating the need to write-off the margin liability and recognize a large gain. By unlocking the margin, there would be no need to separately monitor a portfolio for onerous contracts after contract inception thus reducing operational complexity.
- Transition under the BBA Model -- Unlocking the margin will also facilitate transition. By unlocking the margin, the ED's requirement to reassess the expected margin at contract inception and then amortize such margin to the date of adoption would no longer be necessary. Instead, the margin liability at the date of adoption would be the current estimate of a portfolio's unearned profit. In addition to reducing operational complexity at transition, the margin liability established at the date of adoption would be more relevant and would provide an improved reflection of earnings emergence for in-force books of business at the time of adoption.

With respect to the immediate recognition of all changes in estimates of future cash flows, we believe a sufficiently large portion of such changes would be reflected in the period of the change through revisions to previously reported margins (e.g., by applying the retrospective approach to adjust the margin). This would alert readers of the financial statements to the underlying issue. Further, the full amount of the change in expected cash flows could be a required disclosure, principally through the roll forward of the margin liability.

- Discounting PAA Post-Coverage Liabilities for Property/Casualty Insurers – While we agree with discounting from a theoretical perspective, we are concerned with the implications to earnings as well as the operational complexities to preparers of financial statements. We believe the proposed application of discounting in the PAA creates an inappropriate level of profitability during the coverage period. Although a risk adjustment or margin in the post-coverage liability provides one answer to resolve this issue, we agree with the FASB's conclusion to exclude a risk adjustment to post-coverage liabilities as required by the IASB for reasons cited in the ED (e.g., simply not a reliable or comparable measurement for financial reporting purposes). Because margin for uncertainty is considered in determining capital adequacy, it is reflected in capital and need not be reflected as an additional liability in the balance sheet. Therefore, we continue to believe the best course of action is to eliminate the discounting of liabilities for incurred claims under the PAA model from a cost/benefit perspective for the following reasons:
 - Discounting results in a non-economic acceleration of earnings during the coverage period. By eliminating discounting, earnings emergence would be decelerated and more consistent with both economics and the release from risk principles in the ED.
 - Discounting will obscure key metrics used to understand operating results and, consequently, management and analysts will likely continue to review financial

information without the effect of discounting. Standard industry ratios such as loss, expense, and combined ratios will certainly continue to be monitored by management and, most likely, by financial statement users.

- Discounting will give rise to operational complexities and significant costs to the industry as well as increase uncertainty with respect to significant accounting judgments (e.g., estimation of claim payment patterns).
- If users do not adjust earnings for the effect of discounting, there is a potential unintended market effect on competition and pricing. New entrants into the property/casualty insurance market will experience higher returns faster than is currently the case and could more readily raise capital, creating a competitive disadvantage for established insurers (for which the acceleration of earnings on new business will be mostly offset by the accretion of discount on in-force business). Pricing competition could result in a reduction of capital adequacy for individual property/casualty insurers.

Refer to a financial example in Question 15 in the Appendix on Pages 20-22 that illustrates the significant acceleration of earnings under U.S. GAAP proposed in the ED compared to current U.S. GAAP for a long-tail insurance contract.

We prefer the FASB takes the following positions:

1. Discounting of financial post-coverage liabilities under the PAA model be limited to those liabilities for which the future claim payment pattern is fixed and reliably determinable (e.g., minimal uncertainty in variability of claims). In these cases, future investment income is reasonably assured and any risk adjustment would be insignificant; and
2. Disclosures could be expanded to include a table of expected claim payments by year based on contractual obligations at the balance sheet date. Alternatively, the effect of discounting all post-coverage liabilities under the PAA model could be required as a detailed disclosure. Either disclosure will provide users with the desired information without any of the adverse consequences of discounting noted above.

If the Board decides to proceed with discounting the PAA liabilities, we strongly recommend they simplify the discounting requirements under the PAA model. We believe the most practical solution is to require the discount rate be a risk-free rate. This revision would both reduce the acceleration of earnings from discounting of PAA post-coverage liabilities and the operational complexity. Given the earnings emergence under the PAA is fundamentally different from the BBA, we believe this difference between the two models can be supported from a technical perspective as follows:

1. In the context of the PAA model, the liquidity premium in the “bottom-up” approach should be eliminated from determining the discount rate because of its somewhat illogical effect on income, difficulty to accurately support in the context of financial reporting (e.g., by portfolio by quarter), and its operational complexity and cost. The liquidity premium further accelerates earnings of property/casualty insurers by creating a higher discount rate for the most risky lines of business, such as long-tail casualty lines. These lines of business would be the most illiquid to transfer and as such would have the greatest liquidity premium and therefore the highest discount rate. We believe this result

is inconsistent with the release from risk principle of profit recognition applied in the BBA and coverage period of the PAA (based on timing of incurred claims).

Another benefit of removing the liquidity premium in the PAA model involves a reduction in the operational complexity of discounting the liability for incurred claims. Fundamentally, discounting creates a significant operational burden by requiring the issuers of property/casualty insurance contracts to track both the discount rate at contract inception and the balance sheet date and to determine the extent of discount impacting income versus other comprehensive income. This process is further complicated by requiring insurers to track two components at contract inception and each balance sheet date, both the risk-free rate and a liquidity premium. The operational difficulty is then further exacerbated because the determination of a liquidity premium at a given balance sheet date requires judgment and market analysis. Accordingly, we believe the elimination of the liquidity premium from the discount rate would benefit both financial statement users (more relevant earning emergence) and preparers (less operational complexity).

2. The “top-down” approach can then be eliminated as an option for discounting PAA post-coverage liabilities because issuers of property/casualty insurance contracts generally do not match assets and liabilities of their products. This will ensure all PAA liabilities are discounted in a similar manner simply using a risk-free rate. Because interest is a more integral component of life, annuity, and other insurance contracts to be accounted for under the BBA model, and the earnings emergence differs between the BBA and PAA models, we believe inclusion of the top-down approach in the BBA and not the PAA model is supportable.
- Limited Option to Report Changes in Discount through Income – To best promote the symmetry between accounting for invested assets and policy liabilities and provide a practical expedient for preparers, we recommend policy issuers be given an option to report the effect of changes in discount rates through income instead of other comprehensive income for an insurance portfolio when the following two conditions are met: i) invested assets of the insurance portfolio are separately managed and tracked; and ii) all of the separately managed invested assets are reflected at fair value with changes in fair value affecting income (due to exercise of the fair value option or categorization of the assets as trading or comparable classification under the new Financial Instrument guidance). This option would be applicable to both the PAA and BBA models.
 - Top-line Revenue Recognition under the BBA Model – While we agree with the Board’s conclusions requiring margins, or bottom-line profits, to be recognized into income consistent with an insurer’s release from risk, we do not believe this should be applied to top-line insurance revenues for long-term contracts reported under the BBA model. From a user’s perspective, the estimated portion of premiums that applies to the perceived risk in a given period is not a meaningful metric of sales for long-term products. It is a contrived number which does not translate into a useful measure as to how the insurer performed in a given period. Instead, the premium received or due in a given period provides a more useful and meaningful measure as to how the insurer performed from a sales perspective in a given period. While we do not consider this a cost/benefit issue, it is noteworthy that there would be significant operational complexity and costs to implement this guidance as proposed in the ED.

Key Recommended Changes for which there is Minimal or No Perceived Benefit to Financial Reporting

Examples of areas for which we believe the cost of applying the standard is not commensurate with any perceived benefit to financial statement users include:

- Participating Contracts with Discretionary Features – First, we agree with the Board’s conclusions on participating products for which policyholder liabilities are contractually-linked to invested assets. From a theoretical perspective, we also understand the ED’s distinction between participating contracts for which the policy account balances are contractually-linked to the performance of underlying invested assets (e.g., most unit-linked and separate account products) versus those participating contracts for which credited interest rates to policy account balances are at the insurer’s discretion based on the performance of underlying invested assets (e.g., most universal life and deferred annuity contracts). However, when the effect of this decision is applied to universal life and deferred annuity contracts, we believe the benefit to financial statement users is questionable at best and the cost of valuing the liabilities based on the BBA model versus the policyholder account balance is not commensurate with any perceived benefit to financial reporting. Therefore, we recommend the FASB expands the guidance for participating contracts with contractually-linked contracts to those with discretionary participating features. Similar to contractually-linked products, we recommend the account balance be unbundled and reported separately as an investment component whereas cash inflows from fees, such as surrender fees, administrative fees, cost of insurance, and secondary guarantees currently accounted for under SOP 03-1, be reported under the BBA model. This is an area in which the Board can simplify the accounting and make the overall implementation of the new standard more workable.

The unbundling of the investment component for these contracts will also render the statement of comprehensive income more decision-useful. Although an earnings analysis of FAS 97 investment and universal life contracts is difficult to decipher from today’s U.S. GAAP income statement, accounting ledgers are maintained in sufficient detail to derive useful earnings reports by source that segregate profit or loss from underlying investment spreads, surrender fees, mortality charges, administrative fees, and guarantee fees. By combining both investment spread and other fee income within the BBA model, the preparation of earnings analyses by source will become more difficult under the proposed ED (e.g., need to obtain information from policy administrative systems and not accounting ledgers).

- Universal Life – We believe unbundling of the policyholder account balance provides a more relevant basis to report the investment component of the liability. The BBA model would require preparers to: i) assume a future interest crediting rate to estimate future cash outflows, but then discount such future payment streams with a different discount rate; and ii) stochastically model premium payments that are typically flexible under these contracts. These two exercises would add complexity and judgment to the financial statements with minimal, if any, discernible benefit. In contrast, the policyholder account balance represents the insurer’s obligation to perform under these contracts. Because the investment spread is a large source of earnings for this product, we believe the income statement presentation is best reflected as the difference between the asset performance and interest credited to policyholders. In the BBA model, earnings emerge as the difference between asset performance and the accretion of management’s estimated discount rate, which is less relevant to the underlying insurance contract than interest credited to policyholders.

- Deferred or Fixed Annuities – We believe unbundling the policyholder account balance provides a more relevant basis to report the investment component of the liability and should eliminate the requirement under the BBA model to model the annuity option which is historically exercised by a minority of policyholders (refer to comments on the “Unexercised Policy Options and Endorsements when Assessing Contract Boundary and Contractual Cash Flows” on Page 10). Similar to universal life, the spread between investment income on assets and the interest credited to policyholders provides a more relevant measure of earnings for these policies. Even if the annuity option is not considered part of contract boundary until it is exercised, we believe the contracts should be viewed as insurance because most deferred annuity contracts guarantee a minimum interest rate through the life of the contract holder (e.g., life contingent), which differentiates these products from a financial instrument that guarantees a rate for a period certain.

Because the BBA liability would exclude cash flows related to the investment spread on the unbundled investment component, the margin liability would be limited to profits on contractual fees modeled under the BBA. In contrast to contractually-linked products, such as unit-linked and Separate Account products, investment spread is a large component of contractual profits. Consequently, for some participating contracts with discretionary features, the deferral of all qualifying acquisition costs could potentially be limited to the margin from contractual fees even though they would be fully recoverable from profits related to the spread between interest earned on assets and credited on policy liabilities. In these specific situations, we believe a negative margin liability should be allowed if such asset is clearly recoverable from profits on the spread.

- PAA Requirement to use Probability-Weighted Estimates in Valuing Insurance Liabilities – From a practical perspective, we believe the current U.S. GAAP requirement to establish reserves consistent with management’s best estimate is better for financial reporting than the use of probability-weighted averages as proposed under the ED. Therefore, we suggest FASB either retains the current best estimate requirement to measure PAA liabilities, specify that probability-weighted measurements do not require probability weighting assumptions by scenario in the context of the model, and/or clarify that a simple average of realistic actuarial point estimates would be acceptable to measure the liability for incurred claims. From a theoretical accounting and economic perspective, we acknowledge that the use of probability-weighted averages to estimate contract liabilities for property/casualty insurance contracts under the PAA is a relevant measure because of the uncertainty in ultimate cash flows for most property/casualty products. For example, if the magnitude of potential adverse claim scenarios relative to a median or mode (best estimate under current U.S. GAAP) exceeds the magnitude of favorable claim scenarios relative to a median or mode, we believe a higher nominal reserve would be established as the result of applying a probability-weighted average versus a best estimate. This result would be relevant for that line of business. While somewhat ironic, the uncertainty of both the timing and amount of cash flows for most property/casualty contracts that renders a probability-weighted measurement relevant in theory also renders the measurement less reliable in practice. For many property/casualty lines, determining cash flow scenarios that represent outliers and then assigning a probability for such scenarios requires too much judgment making it difficult for the results to be credible. The considerable judgment to be applied can render the estimates unreliable for financial reporting purposes. As evidence of this point, property/casualty insurers do not uniformly use probability-weighted averages to develop pricing because the assumptions are simply not reliable, even though the analysis itself would provide a relevant basis for pricing if derived reliably.

- Mortgage Guaranty Insurance – Through its wholly-owned subsidiary, United Guaranty Corporation, AIG sells mortgage guaranty insurance products. Under this proposal, this business will likely be accounted for under the BBA model due to its long-duration. While the BBA model improves two potential deficiencies in current practice cited below, we believe the application of the PAA model would result in similar improvements relative to current practice with less complexity, cost, volatility, and accounting judgments. Application of the BBA model would require mortgage insurers to project future defaults through a probability-weighted measure over a 15-year or more mortgage term. This exercise will substantially increase the use of estimates, certain of which will be highly judgmental since based on future economic assumptions, in the financial statements of mortgage guaranty insurers. From a reserving perspective, the PAA model would allow mortgage insurers to report the liability for incurred claims based on incurred defaults at the balance sheet date as done today (less a discount). This measurement provides users with a more reliable and stable basis to assess performance. Although the reserve would be established on an incurred basis, onerous contract will be assessed on an expected value model consistent with the proposed guidance in the ED on Credit Impairments. While the benefit of using the BBA and PAA can be viewed as similar, the PAA model is less complex and costly to implement relative to the BBA model.

Consequently, we recommend the FASB allows mortgage guaranty insurers to apply the PAA model by citing a specific example in the ED. Two areas in which current practice can be improved include: i) for periodic pay policies, revenue is recognized evenly over the coverage period whereas the underlying risk or emergence of defaults tend to be lower in the early and later years of a mortgage and greater during the middle years of a mortgage; and ii) there is currently a lag between a significant economic event and the recognition of related claims that are based on the date of default. We recognize that the BBA model would improve practice for these two areas. If the PAA model was to be applied to mortgage guaranty insurance, we believe these two areas would also be improved relative to current practice as follows:

1. Under the PAA model, revenue would be recognized based on the expected timing of incurred claims (as likely applied to expected premiums on a portfolio basis). Accordingly, for periodic pay policies, revenue would no longer be recognized evenly over the coverage period but would be recognized consistent with expected defaults for a particular portfolio segregated by type of mortgage and underwriting year (e.g., lower in earlier and later years of a portfolio and greater during the middle years of a portfolio).
2. Currently, there is a lag between the occurrence of a “catastrophic” economic event, such as the 2008-2009 economic crisis, and claim recognition in the financial statements. Although mortgage guaranty insurers perform premium deficiency tests by type of product, they are currently not required to do so by duration or underwriting year. By applying the more granular guidance for portfolio when assessing whether or not an onerous contract exists, testing will need to be performed by underwriting year. This new guidance will ensure losses are recognized for the underwriting years most affected by the “catastrophic” economic event, and profitable underwriting years will not prevent recognition of losses from the unprofitable underwriting years.

To support the designation of mortgage guaranty insurance under the PAA model, the second criteria could be narrowly applied for mortgage guaranty insurance without inadvertently allowing other products to fall within the PAA model. For mortgage guaranty insurance, expected default rates at contract inception do not vary significantly until there is a definitive economic event (nationally or regionally) that causes changes in default rates. This is very similar

to long-term catastrophe coverage in which expected average losses do not change significantly until the occurrence of a catastrophe event. Refer to comments on “Determining which Model to Apply” on Pages 11-12.

- Unexercised Policy Options and Endorsements when Assessing Contract Boundary and Contractual Cash Flows – We believe the Board’s guidance in this area could be clearer, particularly as it relates to unexercised options. If it is the Board’s intent that unexercised policy endorsements or options that expand or change existing coverage be excluded from contract boundary and contractual cash flows, this should be clearly stated within Contract Boundary. On one hand, this seems to be the Board’s intent based on summarized guidance within the table on Page 380 and, again, in the section on unearned premium reserves on Page 385, which states “Expectations of future changes in coverage, such as endorsements or reductions of coverage, should not be considered”. On the other hand, the guidance in paragraph 834-10-30-7 seems a bit contradictory by indicating that conversion options be included within contractual cash flows, even though they similarly alter insurance coverage after exercised by a policyholder. We would prefer that the Board removes unexercised policy options, including conversion options, from contract boundary and contractual cash flows. We believe these options should be accounted for upon exercise or when the insurer’s contractual obligation changes. Generally, we agree with inclusion of other options and guarantees that are applicable to the cash flows of purchased insurance coverages, such as surrender options or lifetime benefit guarantees that are not considered embedded derivatives.

If the Board decides not to make this recommended change, it would be helpful to have specific examples addressing the application of unexercised options and endorsements within the discussion of Contract Boundary. While there are a few relevant references, such as section 834-10-55-23, that suggest an option is not part of a contract’s boundary if it is only exercisable at a market rate at the date of exercise (since no value is given to the policyholder), it would be helpful to list specific examples to assist practitioners. For further examples, please refer to our response to Questions 9 and 10 in the Appendix on Pages 17-18.

- Onerous Contract – Refer to our recommendation on Page 4 to unlock the margin liability which would reduce the operational complexity of monitoring each portfolio for onerous contracts after contract inception.

We believe groupings for onerous contract should be performed at a higher level than currently prescribed in the ED, which is at the portfolio (or reserving) level. For purposes of evaluating and recognizing future expected losses or onerous contracts, we believe it is most appropriate to group business based on how operations are managed, generally by business unit or line of business. This is more consistent with the essence of insurance which is the pooling and diversification of risks (e.g., by pooling risks that are individually uncertain, aggregate expected claims become more predictable). While we disagree with the IASB’s inclusion of “managed together as a single pool” within its definition of portfolio in the context of reserving, we agree with its inclusion in the context of assessing onerous contract. By way of example, actuaries may segregate workers’ compensation business by region because of differences in compensation per risk when calculating reserves, however, we do not believe they similarly need to segregate the workers’ compensation business by region when assessing onerous contract if the management of the workers’ compensation business is performed at a country or higher level. Instead, we believe it is most relevant and administratively easier to perform this assessment on a group of portfolios consistent with the manner in which they are managed and for which financial analyses are routinely prepared. Because of the need to measure the margin and release of risk by

portfolio in the BBA model, the differentiation between the portfolio level for reserving and onerous contract is less critical.

- **Transition** – For the BBA model, the application of a single unlocked margin will greatly simplify transition. Further, the margin to be recognized in income would be more relevant to users since it would reflect the current expectation of profit and not past expectations of profit. Refer to our recommendation on Page 4 related to unlocking of the margin liability.

Convergence with the IASB and Direction of Project

As a global enterprise with a significant number of non-US based entities reporting under IFRS in addition to U.S. GAAP, AIG strongly believes in the convergence of U.S. and international accounting standards. While much progress has been made by the Boards to converge standards, it is clear that there are still fundamental differences between the proposed FASB and IASB insurance models. With the current divergent proposals from the Boards, significant additional cost and administrative burden will be incurred by any multi-national insurer such as AIG, with little perceived additional benefit derived by the users of the financial statements. The magnitude of the differences and costs to administer such differences suggests the ultimate goal of convergence has not yet been achieved. If true convergence cannot be achieved, we recommend that the FASB reassesses the Insurance Contracts project and take one of the following actions:

1. The FASB should incorporate several major revisions to the ED that reduce operational complexities and cost and improve the decision usefulness of the income statement. From our perspective, making the changes noted above would go a long way to achieving this goal. Prior to finalizing both standards, we believe the FASB should engage IASB to revise its final IFRS standard to make as many conforming changes to U.S. GAAP as possible.
2. If the industry issues in applying the guidance in the ED cannot be remedied within the developed framework or through an expansion of the framework to be better aligned with the insurance business model, the FASB should not overhaul current U.S. GAAP through the issuance of new guidance. Instead, we prefer the FASB develops targeted guidance intended to improve certain aspects of the insurance accounting model. For suggestions, refer to comments in the second paragraph of this letter on Pages 1-2.

Additional Guidance to Assist Practitioners in Implementing a New Standard

We believe there are a number of areas in which practitioners would benefit from further guidance, examples, or expanded basis of conclusions. Examples include the following:

- **Determining which Model to Apply** – The second criterion to apply the PAA model (section 834-10-25-18, criterion b) could be clarified by providing additional examples. Literal interpretations suggest the criteria would rarely be met. Two examples that result in a literal failure in which the expected value of claims is changed prior to the occurrence of a claim include: i) the passage of time without a claim reduces the expected value of claims at a particular balance sheet date compared to the expected value of claims at contract inception; and ii) any contract that exceeds a one-year coverage period with a catastrophe load is expected to have significant variability of claims relative to contract inception because actual catastrophe claims will inherently differ from multi-year averages used to estimate the load. While section BC 110 provides some guidance, a more precise example would be helpful. We suspect the Board did not intend a contract to fail

the second criteria for either of these two circumstances so we would recommend additional guidance or examples clarifying the Board's intent.

- Portfolio of Contracts – While current U.S. GAAP only specifies the level of contract groupings when determining whether or not a premium deficiency exists (similar to onerous contract), the ED specifies the level of contract groupings or portfolios that affect the liability measurement, margin measurement, determination of release from risk, and onerous contract. While we understand why similar groupings in these areas are needed under the proposed insurance standard, we are concerned that it would result in much finer data requirements than exist today creating additional operational complexity and cost. To minimize the possibility that insurers too narrowly interpret the guidance resulting in unnecessary operational burdens and cost, greater clarity and examples would be helpful in this area. If portfolio is interpreted to be at a level below current reserving levels, maintenance of more granular portfolios would require greater actuarial, system, and data storage costs. However, we suspect this is not the intent of the ED. Refer to our response to Question 8 in the Appendix on Pages 16-17.

We believe the definition of portfolio can be clarified in two principal respects. First, additional guidance regarding how to interpret “priced similarly” would be helpful to practitioners. While section 834-10-55-49 of the ED indicates that “pricing relative to the risk assumed should be interpreted as similar compensation per unit of risk”, this still requires considerable judgment and could lead to a very narrow interpretation with much greater contract groupings relative to current practice. One interpretation could lead a practitioner to segregate portfolios by state or even county if each territory has differing pricing for risk; however, we suspect the Board did not intend to require such granularity in portfolio. We therefore recommend the ED be updated to either better define how “pricing” requirements should be applied or remove the “pricing” requirement from the definition if it does not alter the main guidance to group similar risks together. Second, the requirement to group contracts of similar “duration” together should be clarified with additional examples.

- Release from Risk in the BBA Model – We believe it is proper to earn profits on an insurance contract consistent with the release from risk as it is a good proxy for the increasing certainty of the actual ultimate profits to be achieved on the portfolio. Our concern is that there is considerable judgment in assessing how risk is released and, as such, there is apt to be inconsistency in practice. To reduce this inconsistency, the Board could provide specific examples as to when the following measures should be used to determine release from risk: i) occurrence of claims; ii) payment of claims; iii) combination of occurrence and payment of claims; and iv) a risk adjustment measure such as cost of capital. Since many products have different sources of earnings that would be included in the margin liability under the BBA (e.g., investment spread, administrative fees, guarantee fees, surrender fees, etc.), the ED can also address circumstances, if any, when more than one release from risk measure should be used to amortize the margin liability of a particular portfolio.
- Unbiased Estimates – Since there have been different interpretations of the Board's intent of using the word “unbiased” with measurement of cash flows, it would be helpful to include a definition of “unbiased” in the glossary. While we note that the term “unbiased measurement of cash flows” is addressed in the Basis for Conclusions, the actual definition of “unbiased” is not included. For example, one can interpret the use of “unbiased” to limit all management changes to actuarial estimates, including management changes to reflect facts or revised assumptions discussed and approved by Reserve Committees. We believe management changes to actuarial assumptions are acceptable and unbiased as long as they are documented to represent reasonable

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estimates based on known facts and supported by company actuaries. Accordingly, we recommend the definition be added to the ED clarifying that “unbiased” refers to “estimates that are developed and supported as reasonable estimates based on relevant facts at the balance sheet date, excluding implicit margins that are not supported as reasonable estimates at the balance sheet date or influenced by a pre-conceived result such as a budget”.

- Unbundling of Service Components – Additional examples, such as various loss mitigation services embedded in insurance contracts that could be sold separately, would be helpful. Because loss mitigation services that increase an insurer’s expenses but reduce policy claims are integral to property/casualty contracts, we believe they should not be unbundled as long as they are integral to the estimation of contractual claims. Also, the basis for conclusions for the examples provided could be expanded to better assist practitioners in reviewing comparable contract features.

Additional guidance in these areas will reduce diversity in practice as well as the number of interpretations necessary to implement the guidance.

* * * * *

Our responses to specific questions raised by the Board are included in the Appendix to this letter. Thank you for the opportunity to present our views. Please contact me at (212) 458-9663 if you have any questions.

Very truly yours,

/s/
Jay Matalon

Head of Insurance Accounting Policy
American International Group, Inc.

cc: Jeffrey M. Farber
Senior Vice President and Deputy Chief Financial Officer
American International Group, Inc.

APPENDIX

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

We agree with the scope and the scope exceptions as proposed in the ED. Establishing the parameters of scope based on the contract instead of the entity, as is the case under current U.S. GAAP, better promotes consistency in practice. Further, it ensures each contract is accounted for based on its substance rather than its form. We also agree with the definition of insurance. While the insurance industry typically uses the term “indemnification” when defining insurance and accounting professionals often use this concept to differentiate insurance from derivatives, we agree with the basis for conclusion, section BC 35, that indicates the term “compensation” is more appropriate for life contracts than “indemnification”. Also, we believe the term “adversely affects the policyholder” within the definition adequately differentiates an insurance from a derivative contract.

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

We generally agree with this guidance but ask the Board to specify two broad exceptions to unbundling service fees we believe are inherently integral to related insurance contracts and will ensure consistency in practice. These broad exceptions are as follows:

1. Because asset management is integral to most insurance contracts, particularly variable annuities, the ED could more clearly specify that asset management fees be excluded from unbundling as a service component. To accomplish this, the ED can more broadly state that “all fees and expenses related to the insurance component should be accounted for within the fulfillment cash flows, for example asset management fees and expenses”. Asset management fees typically fluctuate with the underlying invested assets so inclusion in the insurance liability ensures consistency of assumptions between the insurance liability and asset management fees.
2. For certain non-life contracts, loss mitigation costs are integral to the determination of expected claims and therefore should not be unbundled. Even if a separate component of premium covers an insurer’s cost of loss mitigation, such costs directly reduce the risk or insurance premium because they reduce expected claim costs and should therefore not be segregated from insurance premiums in the financial statements. Further, loss mitigation services are performed over the coverage period and should therefore be recognized over the coverage period consistent with the liability for remaining coverage in the PAA model.

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?

As an investor, AIG is also a user of insurance company financial statements. As a user, our comments to this question would be similar to other points made in this letter.

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

As an investor, AIG is also a user of insurance company financial statements. As a user, our comments to this question would be similar to other points made in this letter.

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

We agree with the FASB's two model approach given inherent differences between shorter-term property/casualty contracts and longer-term life and annuity contracts.

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

We agree. The PAA model is better suited for contracts with coverage periods of one year or less. Recognition of insurance revenues over the coverage or performance period both renders the statement of comprehensive income more useful to users and makes it easy for preparers to administer. However, we request the FASB applies the PAA model to mortgage guaranty insurance which may otherwise be accounted for under the BBA model given the long duration of the contract. Refer to comments on Pages 9-10 of this letter. We believe the application of the BBA and PAA models would result in similar improvements to current U.S. GAAP but the PAA model would involve less complexity, cost, volatility, and accounting judgments.

We also agree with the Board's conclusion that the PAA model should be required if a contract's coverage period is one year or less. Because liability measurement and earnings emergence are fundamentally different between the two models, providing optionality would create unnecessary inconsistencies in practice rendering financial statements less comparable.

To facilitate implementation of this guidance, we recommend a reduction in the extent of policy options or endorsements required to be included in contract boundary as well as more precisely specifying the FASB's intent in this area. Please refer to our answers to Questions 9 and 10 on Pages 17-18 below for further elaboration of our view on contract boundary.

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

We agree. While there are a few options to develop the criterion as to when an insurance contract with a coverage period in excess of one year qualifies for the PAA model, none are perfect. We believe the criterion selected by the FASB represents the best alternative to apply for contracts in excess of one year. However, a literal read could lead a practitioner to conclusions that overly limit its application and are likely not within the "spirit" of the FASB's intent. Therefore, more specific guidance would be helpful in the area. Two examples that result in a literal failure in which the expected value of claims is changed prior to the occurrence of a claim include: i) the passage of time without a claim reduces the expected value of claims at a particular balance sheet date compared to the expected value of claims at contract

inception; and ii) any contract that exceeds a one-year coverage period with a catastrophe load is expected to have significant variability of claims relative to contract inception because actual catastrophe claims will inherently differ from multi-year averages used to estimate the load. While section BC 110 provides some guidance in this latter respect, a more precise example would be helpful. We suspect the Board did not intend a contract to fail this criterion for either of these two circumstances so we would recommend additional guidance or examples clarifying the Board's intent.

The basis for conclusion provided in the ED suggests that variation in the cash outflows, from the presence of a potential insured event, does not necessarily mean that an entity will change its estimates of expected cash flows significantly. It would be helpful to practitioners if the Board clarified how significance should be evaluated in this context by providing qualitative examples. Otherwise, the high level of judgment to apply in this area could lead to inconsistency in application.

It is also noteworthy that the Board included all cash flows (not just claims) when assessing significant variability. In updating this guidance, the Board should also specify how a practitioner should view variability from audit premiums and other similar premium adjustments. These features create significant variability in net cash flows relative to expectations, but often relate to differences between the actual number of insured units versus the expected number of insured units at contract inception used to develop the premium (e.g., number of employees insured during the coverage period for a workers' compensation contract). When these adjustments arise because of a change in the population of underlying insured units and not in the amount of risk per insured, we believe this criterion should still be met. While paragraph BC 209 of the ED seems to cover this concept, it applies to the measurement of the liability for remaining coverage and not necessarily model selection.

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

We believe the "spirit" of the definition of portfolio is very similar to the "spirit" by which actuaries (particularly non-life actuaries) currently group business for reserving purposes. However, we believe some additional clarification as to the FASB's intent on how to apply certain aspects of the definition would be helpful to practitioners and minimize inconsistencies in practice.

We believe groupings for onerous contract should be performed at a higher level than currently prescribed in the ED, which is at the portfolio (or reserving) level. For purposes of evaluating and recognizing future expected losses or onerous contracts, we believe it is most appropriate to group business based on how operations are managed, generally by business unit or line of business. This is more consistent with the essence of insurance which is the pooling and diversification of risks (e.g., by pooling risks that are individually uncertain, aggregate expected claims become more predictable). While we disagree with the IASB's inclusion of "managed together as a single pool" within its definition of portfolio in the context of reserving, we agree with its inclusion in the context of assessing onerous contract. By way of example, actuaries may segregate workers' compensation business by region because of differences in compensation per risk when calculating reserves, however, we do not believe they similarly need to segregate the workers' compensation business by region when assessing onerous contract if the management of the workers' compensation business is performed at a country or higher level. Instead, we believe it is most relevant and administratively easier to perform this assessment on a group of portfolios consistent with the manner in which they are managed and for which financial analyses are routinely prepared.

Because of the need to measure the margin and release of risk by portfolio in the BBA model, the differentiation between the portfolio level for reserving and onerous contract is less critical. Please note

that if the Board was to “unlock” the margin in the BBA model, as previously recommended, onerous contract (or writing down the margin only after a portfolio is expected to incur future losses) would be a non-issue after contract inception.

We believe the definition of portfolio can be clarified in two principal respects. First, additional guidance regarding how to interpret “priced similarly” would be helpful to practitioners. While section 834-10-55-49 of the ED indicates that “pricing relative to the risk assumed should be interpreted as similar compensation per unit of risk”, this still requires considerable judgment and could lead to a very narrow interpretation with much greater contract groupings relative to current practice. One interpretation could lead a practitioner to segregate portfolios by state or even county if each territory has differing pricing for risk; however, we suspect the Board did not intend to require such granularity in portfolio. We therefore recommend the ED be updated to either better define how “pricing” requirement should be applied or remove the “pricing” requirement from the definition if it does not alter the main guidance to group similar risks together. Second, the requirement to group contracts of similar “duration” together should be clarified with additional examples.

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

We generally agree with the Board’s requirements included in the ED on contract boundary; however, we request the FASB better clarifies its intent with respect to policy endorsements for both the PAA and BBA models. Refer to comments in Question 10 on the following page as well as Page 10 of this letter.

We believe that if the insurer is contractually obligated to write the renewals at a specified price that the renewals should be included in the contractual fulfillment cash flows. However, we would ask the Board to exclude from the definition of contract boundary the instances in which the insurer is required to either renew an existing contract or underwrite additional coverage (typically through an endorsement or rider to the existing insurance contract) at a negotiated rate that is subject to a maximum premium. The maximum premium is often included to ensure the policyholder has coverage for this period. In these cases, if the maximum premium significantly exceeds current pricing for either the existing contract or similar coverage, we recommend the FASB excludes such renewals and options from contract boundary. From a theoretical perspective, the insurer still maintains broad flexibility to re-underwrite the risk in these cases. From a practical perspective, it limits the requirement to use the BBA model by non-life insurers (because the inclusion of renewals would extend the coverage period beyond one year) that would be applying the PAA model to the majority of their products. Consequently, it eliminates the exercise of developing numerous pricing scenarios (in addition to numerous claim scenarios) to calculate a probability-weighted expected value measurement for the BBA liability. The operational burden of this exercise is quite significant and we believe it has no financial benefit. Two examples of such contracts are:

- In certain jurisdictions, principally outside the U.S., laws and regulations require an insurer to renew existing coverage. In many of these cases, the renewal premium is limited to a percentage increase of the current premium.
- In many claims-made property/casualty insurance contracts, the policyholder is provided an option or policy endorsement to purchase tail coverage in order to secure insurance for claims reported after the contract is no longer renewed. These policy endorsements often cover a specified number of years and the premium is often subject to negotiation, but cannot exceed a maximum rate. The maximum premium ensures a policyholder has some level of insurance

protection after non-renewal of the contract. Two common examples of situations in which a policyholder non-renews a claims-made contract and purchases tail coverage include the discontinuation of a Board member or Officer from D&O coverage due to the sale of a company and the discontinuation of medical malpractice coverage due to the retirement of a doctor.

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?

Generally yes subject to clarification. We believe the Board's guidance in this area should be clearer, particularly as it relates to unexercised options. If it is the Board's intent that unexercised policy endorsements or options that expand or change existing coverage be excluded from contract boundary and contractual cash flows, this should be clearly stated within Contract Boundary. On one hand, this seems to be the Board's intent based on summarized guidance within the table on Page 380 and, again, in the section on unearned premium reserves on Page 385, which states "Expectations of future changes in coverage, such as endorsements or reductions of coverage, should not be considered". On the other hand, the guidance in paragraph 834-10-30-7 seems a bit contradictory by indicating that conversion options be included within contractual cash flows, even though they similarly alter insurance coverage after exercised by a policyholder. We would prefer that the Board removes unexercised policy options, including conversion options, from contract boundary and contractual cash flows. We believe these options should be accounted for upon exercise or when the insurer's contractual obligation changes. Generally, we agree with inclusion of other options and guarantees that are applicable to the cash flows of purchased insurance coverages, such as surrender options or lifetime benefit guarantees that are not considered embedded derivatives.

If the Board decides not to make this recommended change to the ED, it would be helpful to have specific examples addressing the application of unexercised options and endorsements within the discussion of Contract Boundary. While there are a few relevant references, such as section 834-10-55-23, that suggest an option is not part of a contract's boundary if it is only exercisable at a market rate at the date of exercise (since no value is given to the policyholder), it would be helpful to list specific examples to assist practitioners. Options or endorsements that are not part of contract boundary that could be listed include: i) deferred annuities for which the option to annuitize can only be undertaken at the market rate at the date of exercise; and ii) an endorsement in a claims-made property/casualty contract that allows the policyholder to purchase tail coverage that covers reported claims over a specified number of years after the policy period based on a negotiated premium at the time of exercise. Options or endorsements for which the determination of contract boundary is less clear include: i) deferred annuities where the option to annuitize is based on the current interest rate at the time the annuity is elected, but the expense load to purchase an annuity with the account balance of an existing fixed annuity is lower than that of a new product; and ii) claims-made policy with an endorsement for tail coverage for which the premium is negotiable but cannot exceed a stated maximum. Such a maximum is typical in these endorsements since policyholders want to ensure they have some level of insurance coverage after an event that results in the expiration of coverage, such as the sale of an insured company, retirement of an insured professional, etc. In some claims-made products, such as medical malpractice, these types of endorsements are referred to as death, disability, and retirement riders (DDR). To simplify the accounting and liability valuation, we prefer such endorsements to be excluded from contract boundary, and instead be accounted for if and when exercised.

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

We agree. While we believe immaterial changes need not be made on a quarterly basis, we also believe materiality matters are generally not specifically stated in accounting guidance. Instead, acceptable practice will develop between insurers and their auditors.

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

We generally agree with the approach. However, refer to our comment on the application of probability-weighted measurements in the PAA model on Page 8.

Since there have been different interpretations of the Board's intent of using the word "unbiased" with measurement of cash flows, it would be helpful to include a definition of "unbiased" in the glossary. While we note that the term "unbiased measurement of cash flows" is addressed in the Basis for Conclusions, the actual definition of "unbiased" is not included. For example, one can interpret the use of "unbiased" to limit all management changes to actuarial estimates, including management changes to reflect facts or revised assumptions discussed and approved by Reserve Committees. We believe management changes to actuarial assumptions are acceptable and unbiased as long as they are documented to represent reasonable estimates based on known facts and supported by company actuaries. Accordingly, we recommend the definition be added to the ED clarifying that "unbiased" refers to "estimates that are developed and supported as reasonable estimates based on relevant facts at the balance sheet date, excluding implicit margins that are not supported as reasonable estimates at the balance sheet date or influenced by a pre-conceived result such as a budget".

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

We disagree as we believe the margin liability should be adjusted retrospectively for the current expected profitability based on both actual cash flows and current estimates of future cash flows. As a result, changes in expected cash flows should be partially reflected through income (retrospective adjustment of previous margins recognized on a portfolio) and partially as changes to the margin liability in the balance sheet. Changes to future cash flows represent changes between original profit expectations and current profit expectations that should be recognized in the period in which the insurer is released from risk and not before.

This "unlocking" of the margin will eliminate the need for guidance on onerous contracts which is both complex and counter-intuitive. It is complex in the number of portfolios that must be tracked for onerous contract and illogical in that a full margin liability is retained until a portfolio is projected to lose one dollar and for that dollar, the full margin is taken down at one time. Refer to the Pages 3-4 of this letter for further details and support of this key recommendation.

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

We disagree. While we agree with the discount options in the BBA model, we believe the inputs to discount, including risk-free rates, default premium, and liquidity premiums, should be consistent with the underlying assets. The expected return on invested assets is a key component of pricing and an insurer's profitability. Therefore the reflection of rates based on assets supporting liabilities is more consistent with the business model. While the cost of borrowing could be an input to determine an insurer's targeted rate of return, this is not determinative of actual cash flows in any way.

In applying interest rates to discount PAA liabilities and within the context of the current PAA model that includes discounting without a margin or risk adjustment in the post-coverage period, we believe the liquidity premium should be excluded because it further front loads profits in a manner inconsistent with the economics of these contracts. The emergence of credit spreads and liquidity premiums is best reflected over the claim payment period, as it becomes assured that a default has not occurred, instead of the shorter coverage period. By discounting the liability using a risk-free rate, the credit spread and liquidity premium on investments would be earned as the difference between actual investment income (risk-free rate plus liquidity premium) less accretion of discount using a risk-free rate in each financial reporting period. Further, it would reduce the operational complexity of supporting a liquidity premium (linked to an insurance liability which is typically not readily observable in the market) by portfolio for quarterly financial reporting.

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?

While we agree with discounting from a theoretical perspective, we are concerned with the implications to earnings as well as the operational complexities to preparers of financial statements. We believe the proposed application of discounting in the PAA creates an inappropriate level of profitability during the coverage period. Although a risk adjustment in the post-coverage liability provides one answer to resolve this issue, we agree with the FASB's conclusion to exclude a risk adjustment to post-coverage liabilities as required by the IASB for reasons cited in the ED (e.g., simply not a reliable or comparable measurement for financial reporting purposes). Because margin for uncertainty is considered in determining capital adequacy, it is reflected in capital and need not be reflected as an additional liability in the balance sheet. Therefore, we continue to believe the best course of action is to eliminate the discounting of liabilities for incurred claims under the PAA model from a cost/benefit perspective for the following reasons:

- Discounting results in a non-economic acceleration of earnings during the coverage period. By eliminating discounting, earnings emergence would be decelerated and more consistent with both economics and the release from risk principles in the ED.
- Discounting will obscure key metrics used to understand operating results and, consequently, management and analysts will likely continue to review financial information without the effect of discounting. Standard industry ratios such as loss, expense, and combined ratios will certainly continue to be monitored by management and, most likely, by financial statement users.

- Discounting will give rise to operational complexities and significant costs to the industry as well as increase uncertainty with respect to significant accounting judgments (e.g., estimation of claim payment patterns).
- If users do not adjust earnings for the effect of discounting, there is a potential unintended market effect on competition and pricing. New entrants into the property/casualty insurance market will experience higher returns faster than is currently the case and could more readily raise capital, creating a competitive disadvantage for established insurers (for which the acceleration of earnings on new business will be mostly offset by the accretion of discount on in-force business). Pricing competition could result in a reduction of capital adequacy for individual property/casualty insurers.

By way of example, consider the earnings emergence for a long-tail casualty portfolio of business with a one-year coverage period in which the aggregate premium is \$100 million; the expected losses are \$70 million, and the acquisition costs are \$20 million. For purposes of this example, assume an average claim payout period of 10 years (with no payments in the first year), premiums are fully received at contract inception, a liability discount rate at inception of 4%, and an asset earnings rate of 4.5%. Under this scenario, the U.S. GAAP earnings after the one-year coverage period would be \$14.5 million under current U.S. GAAP but \$34.9 million under the proposed guidance. A high level summary of income after the one-year coverage period is as follows:

Statement of Comprehensive Income	Proposed U.S. GAAP	Current U.S. GAAP	Increase (Decrease) in Income by Applying the ED
	<i>(in millions)</i>		
Premium Revenue	\$100.0	\$100	\$--
Investment Income	4.5	4.5	--
Losses Incurred – Nominal Basis	(70.0)	(70.0)	--
Reserve Discount	22.7	--	22.7
Accretion of Discount	(2.3)	--	(2.3)
Acquisition Costs	<u>(20.0)</u>	<u>(20.0)</u>	<u>0</u>
Operating Income	<u>\$34.9</u>	<u>\$14.5</u>	<u>\$20.4</u>

While this is a relatively extreme example, it illustrates the illogical earnings emergence that can be derived from the PAA model as proposed in the ED. Accordingly, we prefer the FASB takes the following position:

1. Discounting of financial post-coverage liabilities under the PAA model be limited to those liabilities for which the future claim payment pattern is fixed and reliably determinable (e.g., minimal uncertainty in variability of claims). In these cases, future investment income is reasonably assured and any risk adjustment would be insignificant; and
2. Disclosures could be expanded to include a table of expected claim payments by year based on contractual obligations at the balance sheet date. Alternatively, the effect of discounting all post-coverage liabilities under the PAA model could be required as a detailed disclosure. Either disclosure will provide users with the desired information without any of the adverse consequences of discounting noted above.

If the Board decides to proceed with discounting the PAA liabilities, we strongly recommend they simplify the discounting requirements under the PAA model. We believe the most practical solution is to require the discount rate be a risk-free rate. This revision would both reduce the acceleration of earnings from discounting of PAA post-coverage liabilities and the operational complexity. Given the earnings emergence under the PAA is fundamentally different from the BBA, we believe this difference between the two models can be supported from a technical perspective as follows:

1. In the context of the PAA model, the liquidity premium in the “bottom-up” approach should be eliminated from determining the discount rate because of its somewhat illogical effect on income, difficulty to accurately support in the context of financial reporting (e.g., by portfolio by quarter), and its operational complexity and cost. The liquidity premium further accelerates earnings of property/casualty insurers by creating a higher discount rate for the most risky lines of business, such as long-tail casualty lines. These lines of business would be the most illiquid to transfer and as such would have the greatest liquidity premium and therefore the highest discount rate. We believe this result is inconsistent with the release from risk principle of profit recognition applied in the BBA and coverage period of the PAA (based on timing of incurred claims).

Another benefit of removing the liquidity premium in the PAA model involves a reduction in the operational complexity of discounting the liability for incurred claims. Fundamentally, discounting creates a significant operational burden by requiring the issuers of property/casualty insurance contracts to track both the discount rate at contract inception and the balance sheet date and to determine the extent of discount impacting income versus other comprehensive income. This process is further complicated by requiring insurers to track two components at contract inception and each balance sheet date, both the risk-free rate and a liquidity premium. The operational difficulty is then further exacerbated because the determination of a liquidity premium at a given balance sheet date requires judgment and market analysis. Accordingly, we believe the elimination of the liquidity premium from the discount rate would benefit both financial statement users (more relevant earning emergence) and preparers (less operational complexity).

2. The “top-down” approach can then be eliminated as an option for discounting PAA post-coverage liabilities because issuers of property/casualty insurance contracts generally do not match assets and liabilities of their products. This will ensure all PAA liabilities are discounted in a similar manner simply using a risk-free rate. Because interest is a more integral component of life, annuity, and other insurance contracts to be accounted for under the BBA model, and the earnings emergence differs between the BBA and PAA models, we believe inclusion of the top-down approach in the BBA and not the PAA model is supportable.

If the Board proceeds to require discounting for premium allocation approach contracts, 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.

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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.

We agree. However, insurers should be provided a narrow option to reflect changes in discount rates through income. Changes in discount rates should not affect operating income as it would obscure performance of the period and result in a mismatch with accounting for most invested assets even under the proposed Financial Instrument guidance.

To best promote the symmetry between accounting for invested assets and policy liabilities and provide a practical expedient for preparers, we recommend policy issuers be given an option to report the effect of changes in discount rates through income instead of other comprehensive income for an insurance portfolio when the following two conditions are met: i) invested assets of the insurance portfolio are separately managed and tracked; and ii) all of the separately managed invested assets are reflected at fair value with changes in fair value affecting income (due to exercise of the fair value option or categorization of the assets as trading or comparable classification under the new Financial Instrument guidance). This option would be applicable to both the PAA and BBA models.

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

No, as contractual cash outflows are depleted, the extent of accumulated OCI will be naturally reduced. Given the inherent offset of unrealized gain/loss in invested assets and insurance liabilities, a shadow loss recognition test seems unnecessary. Further, the cost of doing such would exceed the benefit to financial reporting.

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?

We generally agree with the discount rate options in the BBA model (refer to Question 14 on Page 20 indicating inputs be based on invested assets and not liabilities). For reasons previously stated, we believe discounting should either be removed from the PAA model entirely or the discount rate revised to a risk-free rate with no optionality. Please refer to Question 15 on Pages 20-22 for further support for our position.

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?

We agree. Original rates are more consistent with the actual investment income generated on assets supporting insurance liabilities. In addition, they are more representative of the interest credited to policyholders in most life and annuity contracts.

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

In the context of the model provided, we agree with the proposal. However, we believe the investment component of participating contracts with discretionary features (e.g., contracts in which the insurer determines the interest crediting rate), such as universal life contracts and deferred annuities, should be unbundled. Please refer to Pages 7-8 of this letter for a full explanation of our position.

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

We agree. We believe there should be no Day 1 gain recognized on an arms-length transaction entered into by independent parties.

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

We support a one-margin approach. This approach is both more practical to implement and results in a more meaningful emergence of earnings than a two-margin approach. A risk adjustment simply requires too much judgment to value in each reporting period making period-to-period and peer-to-peer comparisons of income virtually impossible.

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?

Not applicable. Refer to answer to Question 22 above.

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

We agree (with one exception noted below) that if a loss is expected at contract inception it better represents a cost of the period in which the contract was issued and not a future period. We believe the practical application for non-life contracts will be very rare, particularly since the loss is measured on a portfolio of contracts and not on an individual contract.

For life and annuity contracts, there is one potential situation for which a day one loss would be recognized under the ED but for which we prefer to recognize the loss over time. This situation relates to fixed annuities sold with a specified interest crediting rate in excess of the top-down rate applied for financial purposes but less than the expected asset earnings rate. In these specific cases, we prefer to recognize the perceived loss over time because the ultimate investment yield is subject to change and

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should therefore be a cost of the period in which the assumed yield in pricing has not been achieved by the investment portfolio.

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

We agree. It is a sound theoretical basis to earn profits on an insurance contract consistent with the release from risk as it is a good proxy for the increasing certainty of the actual ultimate profits to be achieved on the portfolio. Our concern is that there is considerable judgment in assessing how risk is released and, as such, there is apt to be inconsistency in practice. To reduce this inconsistency, the Board could provide specific examples as to when the following measures should be used to determine release from risk: i) occurrence of claims; ii) payment of claims; iii) combination of occurrence and payment of claims; and iv) a risk adjustment measure such as cost of capital. Since many products have different sources of earnings that would be included in the margin liability under the BBA (e.g., investment spread, administrative fees, guarantee fees, surrender fees, etc.), the ED can also address circumstances, if any, when more than one release from risk measure should be used to amortize the margin liability of a particular portfolio.

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

We generally agree. In some respects, we believe this is the only viable answer given that cash inflows and outflows are both discounted and accreted through income.

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

We disagree. The margin liability should be unlocked and, as such, changes in the future cash flows should be reflected as retrospective adjustments to income (margins previously earned) and changes to the margin liability at the balance sheet date. Changes to the future cash flows represent changes between original profit expectations and current profit expectations that should be recognized in the period in which the insurer is released from risk and not before. Under unlocking, at the time a portfolio is expected to incur a net loss, the margin liability would have previously been reduced as expected profits deteriorated, thereby eliminating the need to write-off the margin liability and recognize a large gain. Please refer to Pages 3-4 of this letter for further details and support of this key recommendation.

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

We agree with the FASB's view to keep the current U.S. GAAP guidance related to acquisition costs. It would be contradictory to the principles of the proposed guidance to include costs that are not in theory related to either a cash inflow or cash outflow of a specific insurance contract or portfolio.

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

We agree with the Board that the direct acquisition costs are best suited as a contra-liability and that the costs should be recognized consistent with profit recognition. Conceptually, it does not appear that there is any future economic benefit to a cost already incurred, and therefore, classification as an asset is difficult to support. In understanding the overall profitability of an insurance contract over time, it is logical to net the acquisition costs against the margin (under BBA) and the liability for the remaining coverage (under PAA) as this provides the most appropriate profit emergence over the life of the insurance contract.

However, we disagree with the Board's decision to permit entities to recognize all acquisition costs as an expense if the contract coverage period is one year or less and the contract is accounted for under the premium allocation approach because of the reduction of comparability between entities with similar business models. While we appreciate the Board's attempt to reduce complexity for preparers, we prefer to avoid optionality in the application of accounting principles.

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

We agree. As noted in our answer to the Question 29 above, it is logical to have the acquisition costs recognized consistent with the margin and the liability for the remaining coverage as it provides the most appropriate profit emergence over the life of the insurance contract.

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?

We agree. The revenues are a meaningful measure of an entity's performance; therefore, we agree with the Board that the users of the 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 as revenues. This presentation better enables a user to assess operating performance compared to the net presentation. However, as stated on Page 6 of this letter, we disagree with the measurement of top-line revenues under the BBA model.

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

We agree, although we are concerned with the effort necessary to apply this guidance. This is a reasonable technical answer as it recognizes that the substance of these cash flows is financing and not insurance. Removing financing elements from insurance revenues and expenses from the statement of

comprehensive income would significantly reduce judgmental risk transfer issues common to the industry. Also, by excluding these financing elements from insurance revenues, users are provided with a better measurement of the net risk assumed by the insurance entity. While the upfront cost of implementation and required system changes in this area is quite high, there is a financial benefit. While subject to debate, the financial benefit can be viewed to exceed the costs. To avoid misunderstandings of the guidance, we recommend the term “estimated returnable amounts” be revised to “contractually-guaranteed returnable amounts” because these amounts are not estimates but definitive calculations of cash to be returned by the insurer to the insured pursuant to contractual terms.

We disagree with the requirements under Section 834-10-30-33 to classify ceding commissions within insurance revenues. Unlike the basis for conclusion in Section BC 231, we believe the ceding commission is fundamentally different from the ceded premium. When specified in insurance contracts, a ceding commission represents a transfer of direct costs from a ceding company to the reinsurer that proportionately relate to the direct premiums being transferred from a ceding company to a reinsurer. Consistent with the accounting of ceded premium as a reduction of insurance revenues, we believe ceding commission should be a reduction of related expenses. This would ensure that comparisons of acquisition and other expenses to premium are on an apples-to-apples basis and important financial ratios, such as loss and expense ratios, remain relevant. In addition, we believe there will be various administrative inefficiencies from reclassifying ceding commissions as revenue because reinsurance systems and reports must continue to categorize ceding commissions differently from premiums, and statutory and tax information will continue to segregate ceding commissions from premiums.

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

We disagree with discounting the liability for remaining coverage because it adds unnecessary complexity to the accounting model with minimal financial impact. While the discounting of this liability affects GAAP equity, the effect will be minimal given the two criteria for a contract to be included in the PAA model. First, most contracts subject to the PAA model will have a one year coverage period and the vast majority of these will meet the practical expedient. For other contracts with coverage periods in excess of one year, the practical expedient would typically be met. Accordingly, we do not believe a requirement to discount the liability for remaining coverage is necessary from a materiality perspective.

If the Board retains the requirement to discount the liability for remaining coverage, due to immateriality, we 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 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.

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.

The guidance could be applied by preparers since insurers are very knowledgeable about the release from risk concept. The ED could provide more examples regarding application of release from risk. Refer to comments to Question 25 on Page 25. In so doing, it could highlight circumstances in which payment patterns used to discount cash flows can be linked to the recognition of premium revenue and margins in the release from risk context. However, we do not agree with this approach to top-line revenue recognition under the BBA model.

While we agree with the Board's conclusions requiring margins, or bottom-line profits, to be recognized into income consistent with an insurer's release from risk, we do not believe this should be applied to top-line insurance revenues for long-term contracts reported under the BBA model. From a user's perspective, the estimated portion of premiums that applies to the perceived risk in a given period is not a meaningful metric of sales for long-term products. It is a contrived number which does not translate into a useful measure as to how the insurer performed in a given period. Instead, the premium received or due in a given period provides a more useful and meaningful measure as to how the insurer performed from a sales perspective in a given period. While we do not consider this is a cost/benefit issue, it is noteworthy that there would be significant operational complexity and costs to implement this guidance as proposed in the ED.

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

We agree that participation features that are contractually dependent on the performance of other assets or liabilities of the insurer or the performance of the entity itself should be measured on the same basis.

We disagree 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. We recommend the FASB expands the guidance for participating contracts with contractually-linked contracts to those with discretionary participating features. Similar to contractually-linked products, we recommend the account balance be unbundled and reported separately as an investment component whereas cash inflows from fees, such as surrender fees, administrative fees, cost of insurance, and secondary guarantees currently accounted for under SOP 03-1, be reported under the BBA model.

We believe liabilities for contracts in which the insurer determines the interest crediting rate, such as universal life contracts and deferred annuities, should be stated at current policyholder account balance as measured based on policy formulas and maintained in policy administrative systems. This is a more

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meaningful measure of the insurer's obligation at the balance sheet date. Because the investment spread is a large source of earnings for this product, we believe the income statement presentation is best reflected as the difference between the asset performance and interest credited to policyholders. Lastly, the cost of requiring a new valuation system for these products clearly does not exceed any perceived benefits for financial statement users. Please refer to Pages 7-8 of this letter for further details and support of this key recommendation.

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

We believe there should be no upfront gain for any contract entered into through an arms-length negotiation between two independent parties.

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

We agree. Reinsurance contracts group similar risks so it would be relatively rare to have a reinsurance contract cover a material portion of both PAA and BBA contracts. However, as further support for our response to Question 32 on Pages 26-27, for BBA contracts, we are concerned that the accounting for reinsurance can become even more complex than currently the case because the premium earnings and the contractual reinsurance premiums will no longer be aligned (guidance on estimated returnable amounts).

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?

Because the contractual fulfillment model is not a fair value measurement, we believe a calculated loss between recognition of insurance liabilities under the FASB's proposal and fair value or purchase price be reported as a component of goodwill.

Yes, we agree that entities should not record 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 ED. To be consistent with the classification of comparable losses through goodwill noted above, this amount would be reported through goodwill as well.

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?

Generally yes. This is consistent with guidance in SOP 05-1 whereby a substantial modification to an existing contract indicates the existing contract is effectively terminated and a new contract effectively issued. In these cases, the resulting gain or loss on termination of the existing contract seems theoretically proper.

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

We generally agree with the proposals for the presentation of insurance contract revenue and expenses in the ED. In particular, we agree that insurance revenues and expenses be separately disclosed in the statement of comprehensive income. The segregation between revenues and expenses related to the BBA and PAA models and between direct business and reinsurance is also helpful to increase transparency of the financial statements. However, as previously stated we disagree with the method of recognizing insurance revenues in the BBA model, and resulting requirement to report earned premium as opposed to written premium as insurance revenue (e.g., recognize premiums as they become due).

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?

While the individual disclosures seem reasonable, we are concerned that the level of disclosures will be overly burdensome. Users of multi-line insurers' financial statements typically require considerable supplemental information to analyze the statement of comprehensive income on a more disaggregated basis. While the level of disclosure proposed in the ED is substantial, we believe supplemental information will still be needed and in fact, more complicated to prepare for products applying the BBA model.

To ensure the quantity and nature of disclosure is manageable for preparers and users, we suggest reducing the extent of inputs, judgments and assumptions disclosed. Similar to the basic income statement, we believe the reconciliation of the BBA liability will combine several underlying products that will make it difficult for users to properly analyze. Accordingly, we believe this requirement can be removed in an effort to reduce the extent and complexity of required disclosures. However, we believe a reconciliation of the BBA margin liability should still be required as it will provide meaningful information regarding the components of earnings with less complication than a reconciliation of the BBA liability.

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?

As implementation will be significant for all aspects of the insurance company business, including but not limited to product design, planning and forecasting, capital management, actuarial modeling, technology, and financial reporting, we believe that at least 4 years from the issuance of the final guidance would be needed to accomplish all necessary changes. Please refer to response to Question 47 on Pages 32-35 for key drivers to implement the new standard. For those drivers listed in Question 47 please note that there are several underlying products where related systems would have to go through significant modifications if not a complete overhaul.

Given the significant interrelationship between assets and liabilities for insurance companies, we recommend that insurance companies be allowed to adopt new guidance on financial instrument and credit impairments on reinsurance recoverables simultaneously with a new insurance standard.

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?

Yes, the effective date should be the same for all users to promote consistency and comparability.

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?

Yes. However, amending the proposed guidance based on certain recommendations in this letter will facilitate transition.

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

We generally agree with the proposal on business combinations, although we would ask for clarification on how to treat any dispositions that occurred between the first year to be reported under the new standard (e.g., 2016 in the income statement or 2014 for 5-year tables) and the year of adoption (e.g., 2018) of the accounting guidance. A practical expedient for such a situation would be helpful.

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?

Refer to response to Question 44.

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

The proposed standard will affect virtually all of our financial and reserving processes. Because the scope of the significant simultaneous changes to financial and operating systems is unprecedented for the insurance industry, an accurate estimate of total costs to implement the proposed ED cannot be made at this time. Needless to say, with AIG's presence in over 130 countries and numerous product offerings, the costs will be immense and implementation a major challenge. These efforts and costs will be further increased by simultaneous changes to international accounting standards that lack complete convergence as well as the implementation of other FASB standards affecting insurers, such as Financial Instruments, Credit Impairments, and Leases.

The most significant upfront costs and work efforts to implementing the new insurance standard for U.S. GAAP, as currently proposed, will include, but not be limited to, the following:

Life Operations

1. Portfolio Groupings – Determine how insurance products are to be grouped under the current standard. This will likely need to be completed early in the process to appropriately design new financial and reserve valuation systems.
2. New Reserving Model for Life Products – Develop a new dynamic valuation system, including processes and controls, for all life contracts, including whole life, yearly renewable term insurance, and other life products.
3. Monitor and Amortize Margin Liabilities – Develop systems, processes, and controls to measure release from risk to amortize BBA margins and revenues for all life contracts.
4. New Reserving Model for Spread Products not Currently Required – Develop a new system to value the BBA liability, including processes and controls, for spread products that are not contractually linked, including universal life, deferred annuities, and immediate annuities.
5. New Reserving Model for Product Guarantees – Develop new reserving methodology to account for product guarantees currently accounted for under SOP 03-1.
6. System Revisions to Implement Unbundling and Removing Estimated Returnable Amounts from Revenue – Update new policy issuance process to evaluate contracts for service components, investment components, and estimated returnable amounts. Link the new issuance systems and the financial systems so that this information can be used to implement the new accounting models. Then, update financial subsidiary ledgers to properly account for these features.
7. Transition – Evaluate margin liability at the time of adoption on all products. This will require considerable resources to first access the relevant information needed to perform the calculation and secondly, estimate the margin by portfolio. Also, the initial BBA liabilities will need to be established.
8. Reinsurance – Perform a thorough review of reinsurance agreements for estimated returnable amounts and ceding commissions and then update reinsurance systems and processes to capture this information. Processes to value reinsurance assets must then be updated and linked with new reserve valuation systems.

Property/Casualty Operations

1. Evaluate All Contracts for Potential Accounting Changes other than Applying the PAA – Perform thorough review of in-force business to determine the following: i) service and investment components to be unbundled; and ii) estimated returnable amounts. Also, determine which multi-

- year products and one-year products with coverage options must be accounted for under the BBA.
2. Update Systems and Processes for Accounting Changes to be Implemented – Update new policy issuance process and systems to evaluate contracts for service components, investment components, estimated returnable amounts, and if contract is subject to BBA. Also, link the new issuance systems to the financial systems so that this information can be used to implement the new accounting models. Then, update financial subsidiary ledgers to properly account for these features.
 3. Portfolio Groupings – Determine how insurance products are to be grouped under the current standard. This will likely need to be completed early in the process to appropriately design systems to discount the liability for incurred claims.
 4. Apply Reserving Measurement Change from Best Estimate to Probability-Weighted Average – Actuaries must reevaluate the basis of determining nominal reserves and then update their processes and controls to ensure the underlying calculation is based on a probability-weighted averages and not simply a best estimate.
 5. Discounting of Liability for Incurred Claims under the PAA Model – Develop systems, processes, and controls for calculating and maintaining appropriate discount and interest accretion rates by portfolio for non-life contracts under the PAA model. The actuarial process to calculate nominal reserves and expected payment patterns must then be accessible and linked to the process to discount reserves with appropriate controls established to address the various circumstances that could challenge the integrity of the output.
 6. Reinsurance – Perform a thorough review of reinsurance agreements for estimated returnable amounts and ceding commissions and then update reinsurance systems and processes to capture this information. Processes to value reinsurance assets must then be updated and linked with new reserve valuation systems.
 7. Transition – Develop discount by portfolio to be used at the time of adoption.

Corporate

1. Transition – Develop financial statements beginning at least two years prior to the date of adoption.
2. Financial Close Process and Timing – Reconstruct the financial close process for the numerous changes that must be implemented.
3. Disclosures – Ensure financial processes are developed to capture all the new disclosures that must be included in financial statements.
4. Changes to Supplemental Financial Information to Public – Reconfigure financial supplements to capture information that will be meaningful to investors. In this process, we anticipate that many new non-GAAP measures will be included that were formerly GAAP measures. Similar to disclosures, must ensure new and updated systems can provide this information accurately and in a well-controlled manner.
5. Financial Statements – Will need to be reconstructed requiring changes to general ledger mappings and data warehouse systems. Also, separate processes will need to be developed for reconciliation of STAT financial statements to new U.S. GAAP requirements.
6. IFRS – Local countries will need to develop similar systems to implement IFRS and then IFRS results will need to be reconciled to U.S. GAAP.
7. Financial Planning & Analysis – FP&A systems will need to be reconstructed and financial information updated for years prior to adoption to the new standard.

Recurring costs will involve the maintenance and controls related to the new processes. The recurring work effort that is clearly incremental to current work efforts include, but will not be limited to, the following:

1. The accounting for unbundled contract components and the estimated returnable amounts.
2. Updating new BBA liabilities for contracts with discretionary participating features, including universal life, deferred annuities, immediate annuities, single premium deferred annuities, and others, for which the financial statement liability is currently based on policyholder account balance, which is a routine function within policy administration systems for these products.
3. Developing and documenting dynamic assumptions for all life and annuity products on a periodic basis. For affected products, this process will also require additional periodic analytical reviews and controls relative to what is performed today.
4. Performing an onerous contract review at a more granular level than is currently required for premium deficiency or loss recognition tests.
5. Develop and review inputs into release from risk models used to amortize BBA top-line premium and bottom-line profits. Changes in the margin liability and effect on income must be separately reviewed for reasonableness by portfolio.
6. From a property/casualty actuarial perspective, the following will be additive to the current process:
 - a. Determine scenarios and related probabilities to apply to probability-weighted estimates required to value nominal reserves;
 - b. Develop expected payment patterns for each portfolio to be used for discounting. Although this exercise may be performed for tax purposes, such analysis is performed at a higher level than portfolio and is not performed in the context of a financial statement close. Instead, insurers typically have 8.5 months from year end to complete.
 - c. With the assistance of asset management, develop, support, and input both the risk-free interest rate and the liquidity premium to be applied by portfolio by underwriting year.
 - d. Apply controls to ensure actuarial nominal reserves, payment patterns, risk-free interest rates, and liquidity premiums have been properly input and applied into the discounting calculation.
 - e. Perform an analytical review to ensure the calculated discount is reasonable by portfolio.
7. Process and review new disclosures required by the new standard as well as new disclosures within financial supplements.

We believe all of these work efforts will require an increase in staff, principally actuarial, technology, and accounting personnel. Please note that other additional costs to be incurred to implement the guidance that are not identified above since they are not directly related to the preparation of financial statements include training, changes to budgeting and forecasting process, changes to enterprise risk management procedures, changes to underwriting and pricing procedures, product decisions, business strategies, etc.

Consistent with comments made in this letter, we believe the following changes to the ED would make the standard more cost effective:

1. Allow contracts with discretionary participating features (e.g., universal life and deferred annuities) to use policyholder account balance as the basis for financial liabilities.
2. Under the BBA model, revise the revenue recognition requirements so that insurance revenues are recognized as they become due, as is currently done today. This would avoid the overly burdensome need to monitor the difference between cash flows from revenues and revenue recognition based on release from risk within a liability or an asset.

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3. Unlocking the margin on a retrospective basis to facilitate transition and periodic assessments of onerous contracts for products to be accounted for under the BBA model.
4. With respect to onerous contract, allow the review be done at a higher level than portfolio that is used to measure margins under the BBA model and liability for incurred claims under the PAA model.
5. With respect to discounting the liability for incurred claims under the PAA model, either remove the discounting requirement or provide simplifications for the manner in which discount needs to be applied, such as solely requiring discounting at a risk-free rate.
6. Allow the PAA model be applied to mortgage guaranty insurance.

However, even if these comments are acted on, the cost of implementing this standard is substantial and we recommend that the FASB carefully considers this in their review towards a final standard.

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.

Not applicable. Question is for Auditors.