



October 25, 2013

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Financial Accounting Standards Board  
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The Statutory Accounting Principles (E) Working Group (SAPWG) of the NAIC<sup>1</sup> is responsible for the development and enhancement of Statements of Statutory Accounting Principles (SSAPs) used by U.S. insurers in their statutory filings. Statutory Accounting Principles (SAP) presents an effective, comprehensive and understood approach, which has been built using the framework established by U.S. GAAP. Under the SAP process, all new GAAP issuances are considered and ultimately adopted, adopted with modification, or rejected. Although SAP may make some modification, it is preferred to have minimal differences in accounting methodologies between SAP and GAAP, with as limited variations as possible to meet regulatory objectives. Consequently, proposals that significantly revise GAAP standards are a vital matter for U.S. regulators.

We support the International Association of Insurance Supervisors (IAIS) position that “it is preferable if the methodologies for calculating items in general purpose financial reports can be used for, or are substantially consistent with, the methodologies used for supervisory reporting purposes, with as few changes as possible to satisfy supervisory reporting requirements for the purposes of solvency assessment. Achievement of this aim is likely to reduce costs for regulated insurance entities and thereby policyholders.” Required SAP modifications may create additional costs.

Our statements within this letter are predominantly from the viewpoint of the financial statement user. The NAIC’s primary goal is to protect policyholders, including regulation of insurer financial solvency, with direct interest in minimizing differences between GAAP and SAP and supporting convergence with the IFRS. Our comments also stress concerns about the benefits gained from the additional cost and complexity of the proposed guidance. Our primary regulatory goal of protecting policyholder interests includes reviews of insurer solvency, but our responsibilities are not limited to this role. We have a profound interest in ensuring insurers have access to capital markets to obtain capital to expand their business, to provide new and innovative products, to increase competition in existing markets as well as to meet liquidity and capital needs in possible stress situations, all of which are benefits for policyholders. As such, we have a keen interest in the development of general purpose financial statement accounting standards. We hope you find our input within this letter valuable.

### Summary Position

U.S. regulators continue to support a single, high-quality global standard for insurance contracts. Regrettably, the proposed IFRS exposure draft and the proposed ASU do not appear to meet this objective. Consequently, U.S. regulators do not support the proposed ASU for insurance contracts as the guidance will not result in decision-

<sup>1</sup> The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC staff supports these efforts and represents the collective views of state regulators domestically and internationally. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

useful information necessary for financial statement users. We do not believe the proposed ASU improves existing U.S. GAAP. With the inclusion of complexity without necessarily increased precision, the expanded scope for non-insurance products with “insurance risk” and the ultimate financial statement presentation, the proposed ASU will diminish the ability for users to comprehend and compare financial statements resulting from insurance transactions. This proposed guidance will negatively impact regulators’ ability to assess insurance companies using a comprehensive, consolidated approach. Regulators currently use U.S. GAAP financial statements to evaluate the consolidated positions of insurance company groups.

There is widespread agreement between preparers, investors, and other users that existing SAP and financial reporting under current U.S. GAAP is very important in obtaining a comprehensive understanding of reporting entities. Granular information, measured consistently between SAP and U.S. GAAP, allows investors to obtain a better understanding of the operating financial performance and financial condition of insurers. Statutory accounting and reporting has stood the test of time and has proven reliable under a variety of challenging circumstances and is well understood and supported by the investor community. The FASB’s proposal would jeopardize a comprehensive accounting and reporting system that has been in place for decades, and whose efficacy has been continuously validated over time in the face of extreme events and circumstances. The proposed accounting and reporting model is one that is largely untested. The attempt to implement such an untested system would be extremely costly and time consuming for all insurers but likely disproportionately so for the small and mid-sized companies, which compose the majority of insurance reporting entities.

The complex accounting for “current value” was rejected for banks on the grounds that measuring loans and deposits at “current value” is inconsistent with their business model and would not provide information that is decision-useful to investors. We believe the same conclusion should be reached with the proposed insurance contract ASU. We are concerned that a “current value” model – akin to a level 3 fair value (unobservable inputs) – for insurers may not be beneficial to investors or be verifiable by independent audit. Expectations that can drastically change based on minor differences in assumptions are best limited to the Management’s Discussion and Analysis (MD&A) and should not be presented in financial statements representing current performance results. If the proposal goes forward, and banks are allowed to retain their cost-based balance sheet, insurers may be at a significant competitive disadvantage in the ability to attract capital investments.

#### Convergence with IFRS

The FASB proposed ASU clearly indicates that the exposure draft does not converge with the proposed IFRS. U.S. regulators support high-quality, converged standards. In making this statement, it is important to highlight that greater emphasis must be placed on “high-quality” than the need for a converged standard. (With this emphasis, we strongly support the majority of FASB conclusions in comparison to those reached by the IFRS.) However, without expectations for arriving at a converged standard, reconsideration must occur on whether this project – to completely revise the accounting for insurance contracts – should continue if the result does not produce high-quality financial statements that reflect an improvement to existing U.S. GAAP.

In the exposure drafts, the IASB and FASB have identified several areas where convergence is not achieved, but the discussions do not reflect a full assessment of the non-converged aspects. Without the Boards discussing all of the variations, and the intent behind the differences, readers are left speculating on the intent of disparities. The differences between the FASB/IFRS exposures encompass all aspects of the proposed standards, but some differences are immediately identifiable through a comparison of the glossary of terms. The IASB and FASB have different terms defined, and for several, which are common to both proposals, the definitions are different. As recognized by the FASB with the development and issuance of *ASU 2011-04, Fair Value Measurement – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRS*, use of different words and phrases in accounting guidance results in different interpretations. Knowing this, readers must assume that current variations in the FASB/IFRS exposed guidance are intended to produce different accounting results.

To ensure the intent, and to clarify the understanding of expected differences, it is recommended that the Boards conduct a thorough review of the standards to identify all variations and, if convergence is intended, ensure that

identical words, phrases and examples are included. For all areas in which converged agreement cannot be reached, the accounting guidance should explicitly discuss these variations, and the expected application impact, allowing users to understand comparison limitations between the IFRS and GAAP proposals.

The following highlights two distinct differences that lack discussion in the exposures:

- **Distinct Investment Components**: The guidance for separating “distinct investment components” in the exposures appears to be converged (*FASB ASU 835-10-25-1 through 835-10-25-10, and IFRS paragraphs 9-11*). However, a review of the glossary highlights that the IASB and FASB have significant differences in what is defined as an “investment component” subject to the noted guidance. With the different definitions, the application of the “converged” guidance will have materially different results – directly impacting the measurement of insurance contracts and the calculation of insurance contract revenue and expenses.
- **Portfolio Definition**: Although the FASB specifically inquires about the portfolio definition in their exposure, there is limited discussion highlighting the differences between the IASB and FASB portfolio definitions and how the definitions will apply in practice. Since the FASB notes consideration of the IASB definition, it is clear that these differences are not inadvertent – but uncertainty exists as how the different definitions will be applied. We speculate that the FASB intends to have less aggregation, with more “portfolios” than the IFRS (as the IFRS definition allows management as a single pool), but without this discussion, it is likely that other users, auditors and preparers may assume the FASB had a different intent.

*As the portfolio definition impacts all aspects of the standards – recognition, measurement/carrying amount, determination of qualifying acquisition costs and other expected cash outflows, discounting requirements, and presentation of insurance assets and liabilities – it is our opinion that different definitions between the IASB and FASB on this term alone almost negates any converged conclusions throughout the standards.*

#### Scope & Scope Exclusions (Question 1)

The proposed ASU incorporates a definition of “significant insurance risk” that differs from existing GAAP, with a proposal to eliminate the requirement for the loss to be reasonably possible. This new definition pulls in items that have not traditionally been considered insurance, and will require non-insurers to apply the complex insurance standard. Insurance entities are often compared to other financial institutions. The presentation of a net “insurance asset/liability” or “insurance contract revenue” in the financial statements for a non-licensed entity that provides a product with insurance risk (e.g., stand-by letter of credit) – perhaps with multiple other financial products – may not be beneficial for comparison purposes, or assist with understanding the non-licensed entity’s operations through a simple financial statement review.

For reinsurance, the proposed guidance would incorporate a lower threshold for risk transfer, allowing insurance treatment for contracts that do not expose the reinsurer to the possibility of a significant loss. Similar to the comment above, the intermixing of different products – rather than separate identification (accounting and reporting) for reinsurance transactions that meet the insurance definition and those that do not – does not improve the ability of users to effectively understand a reporting entity’s operations and financial position.

#### Bifurcation of Noninsurance Components (Question 2)

As initially identified, non-convergence in IASB/FASB terms for the bifurcation of non-insurance components is concerning. The variations between the Boards’ “investment component” definitions will have a significant impact on the items included (items with investment risk or items returnable to the policyholder without an insured event) within the parameters of an insurance contract, and the components excluded and measured under non-insurance guidance. For items expected to be excluded and measured separately, we stress the difficulty in assessing the impact of different accounting guidance particularly as the standards for revenue recognition and financial instruments have yet to be issued. Without those final standards, it is impossible to assess whether the non-insurance bifurcations proposed in the ASU will materially influence the financial results of the entity, and

whether these complex requirements will provide sufficient decision useful information to justify the cost of implementation.

#### Initial and Subsequent Measurement – Relevant Information / Improvements to GAAP (Questions 3-4)

The Basis for Conclusions identifies the objective of the insurance contract project to improve, simplify and enhance the financial reporting requirements for insurance contracts and to provide investors with decision-useful information. However, in reviewing the exposure for improvements in terms of consistency, comparability, and transparency, there are limited items that will readily result in financial statement improvements. Although identifying various concerns with cost, complexity and overall application, our most significant concern is the resulting financial statements. Fundamentally, the reporting of a net asset or net liability for each insurance portfolio will not provide useful information on the face of the financial statements. As identified in our 2010 comment letter, financial statement users benefit from the reporting of unearned premium reserves and claim reserves as well as uncollected premium balances. As there generally would not be a right to offset between assets receivable from one policyholder to the claims obligated to other policyholders – regardless if they are grouped in a portfolio – the proposed financial statement presentation does not provide sufficient financial data. As loss reserves and unearned premium reserves provide important information to users, the proposed presentation excluding this detail will result in significant reduction of decision-useful information from financial statements.

As one significant improvement, U.S. regulators strongly support the proposed inclusion of undiscounted claims development, as it is critical information allowing users to understand the insurer’s ability to properly underwrite and anticipate claims. With this new disclosure, which can be completed by insurers without cost or complexity as it is already required under statutory accounting principles, users of U.S. GAAP financials will be able to readily obtain this key performance information.

#### Measurement Approaches (Questions 5-7)

U.S. regulators strongly support the different approaches (Building Block Approach—BBA & Premium Allocation Approach—PAA) for insurance contracts proposed in the exposure draft. As noted in our 2010 comment letter, we strongly prefer the continuation of a two-model approach whereby the accounting for short-term insurance contracts is separate and distinct from other insurance contracts. We believe that forcing similar measurement models for contracts with fundamental differences in their characteristics will decrease the investor/user usefulness of the information.

With the two distinct measurement approaches, the combining of guidance within a single standard is confusing. In reading the exposure, (and completing the necessary page flipping to focus on a specific measurement approach), it is difficult to collectively assess the aspects of the guidance for the Building Block Approach (BBA), and the aspects that are specific to contracts measured under the Premium Allocation Approach (PAA). As the FASB has determined that the measurement approaches are different, a simple way to improve the readability and reduce uncertainty would be to issue separate standards. At a minimum, we recommend that the FASB reformat the proposed standard to separate the guidance for the different methods. (All guidance for BAA – initial measurement, subsequent measurement, disclosure, presentation and illustrations – should be combined within a designated section). Reformatting in this manner would improve readability of the guidance and eliminate the need to flip pages and search for the next relevant section.

U.S. regulators strongly support requiring the premium allocation approach if specific criteria is met. Consistent accounting for entities that have contracts that fall within the PAA is necessary for users of financial statements.

We also strongly support the guidance that requires the PAA to be applied without further evaluation if the contract’s coverage period is one year or less. We are concerned, however, that this guidance will ultimately be interpreted as the only element that allows for PAA application. It is unclear how an insurer would document the “unlikelihood of significant variability of the cash flows” for contracts that exceed one year, and with this uncertainty, practical application of the PAA approach will likely depend on the “one-year or less” guideline regardless of the FASB’s original intent.

Per examples in 834-10-55-53, there are only two instances in which the PAA is identified for contracts with coverage periods in excess of one-year, and the rationale supporting both is not clear under the guidance:

- Surety Bonds – 3-Year Coverage Period: Exposure identifies PAA application based on the financial stability and historical experience of the insured. Per this example, it seems either these types of products can be PAA or BBA based on the assessment of the credit quality of the insured. With this subjective assessment, it is uncertain how insurers will differentiate and document products as PAA to satisfy auditor expectations. With these parameters, similar products would be accounted for differently based only on the insurer’s subjective assessment of the insured.
- Workers Comp – 18 Month Coverage / 20-Year Payout: Exposure implies PAA as the appropriate method as the insurer has the ability to fully underwrite the contract and re-price after 18 months. This conclusion is contradictory to the guidance in the basis of conclusions (BC113) where it is identified that the FASB rejected the criteria in existing US GAAP that requires contracts to be accounted for using the short-duration model if the contract provides insurance protection for a fixed period of short duration and the contract enables the insurer to cancel the contract or to adjust the provisions of the contract at the end of any contract period, such as adjusting the amount of premium charged or coverage provided. The Board rejected this guidance as most contracts typically can be repriced at the end of the contract period for renewals, and this is a component of the contract boundary. With the conflicting rationale to BC113, further information is needed to understand how this contract qualifies for PAA.

To improve consistency and reduce subjectivity, the requirement to use PAA based on coverage period length should be expanded. In reviewing the examples for the BBA, the two shorter-term scenarios (one-year and five year) both include either guaranteed renewals, or renewals without evidence of insurability. If the intent is for the PAA method to capture everything less than 5-years unless these renewal options exist, a more consistent, easier application would include these provisions within the PAA parameters. If this is not the intent, scenarios should be included to illustrate how shorter-term (less than 5-year) coverage periods without guaranteed renewals, or renewals without evidence of insurability, are determined outside of the PAA and within the BBA.

#### Portfolio and Contract Boundary (Questions 8-9)

The definition of a “portfolio” is the most important determinant in the exposure, as all of the following are determined with that assessment: 1) insurance contract recognition; 2) measurement / carrying amount; 3) determination of qualifying acquisition costs and other expected cash outflows; 4) discounting requirements (whether required under PAA); and 5) presentation of insurance assets / liabilities in the financial statements. With the deliberate IASB/FASB decisions to have different “portfolio” definitions, we have no expectation that any “converged” aspects of the separate proposals will result with comparable financial results.

U.S. regulators do not favor or have concerns with either of the definitions proposed by the Boards, but stress the need to have a converged definition, with identical language, to eliminate any speculation on intended differences. If convergence on what comprises a “portfolio” is not possible, the standards should include information on how the definition variations are expected to be interpreted and applied. For example, with the current FASB definition, it is anticipated that the deliberate differences from the IASB were intended to impact the amount of aggregation within the standard (with the FASB allowing less aggregation – as that definition specifies aggregation of similar risks with similar duration, which would seemingly prevent portfolios of life contracts that include both 20 year-old and 60 year-olds, although they are managed together as a single pool). However, without clear discussion of that intent, it is uncertain whether that interpretation is correct or will be collectively achieved.

U.S. regulators have not identified significant concerns with the proposed contract boundary guidance. It appears that comments received from the 2010 Discussion Draft have generally been reflected, as the current proposal is not limited to individual contracts, but includes the right to reassess risk on a portfolio basis, and reflects the impact of regulatory restrictions. There could be situations (state regulations) that prohibit an insurer from vacating a market, but also restrict an insurer from raising rates to fully reflect the contract’s risk. Although

potentially contingent on the portfolio definition interpretation, the proposed ASU does not seem to address these situations. We recommend guidance to ensure consistency, even if such guidance is limited to the U.S.

### Fulfillment Cash Flows (Questions 10-12)

The most significant application difference between the FASB and IASB exposure drafts is the measurement of insurance contracts. The FASB exposure draft measures a portfolio of insurance contracts based on (1) fulfillment cash flows and (2) a margin, which is the fulfillment cash inflows in excess of the fulfillment cash outflows (unearned profit). The IASB exposure draft measures insurance contracts based on (1) expected cash flows, (2) risk adjustment, and (3) contractual service margin. U.S. regulators strongly support the FASB proposal for a single “composite” margin rather than the IASB “risk and contractual service margin” approach, as a separate judgment of “risk” results in inherent uncertainty, potential manipulation and comparability concerns.

To reiterate initial comments, the NAIC supports high-quality, converged standards, but the desire for convergence is inferior to the need for high-quality standards for investors/users. U.S. regulators agree it is not possible to objectively compute a risk assessment, and therefore, strongly support the FASB conclusion that the risk adjustment and the contractual service margin can vary significantly by insurer for the same risk, thereby producing different results in financial statements. We agree that the IASB proposal for measuring insurance contracts is clearly not suitable as U.S. GAAP because it cannot be consistently applied or objectively determined or measured and would hinder assessment by financial statement users.

With regards to the specific fulfillment cash flows that are included/excluded in the IASB/FASB exposure drafts, similar to our 2010 comments, the current proposal for “fulfillment cash flows” currently excludes certain cash flows that are relevant to the fulfillment of an insurance contract (e.g., general overhead and premium taxes). To the extent that policy premiums have not been set to adequately consider the full cost of insurance contract fulfillment, the initial liability would be understated, with an effective ‘premium deficiency’ not captured as a loss until those future fulfillment expenditures actually occur.

Consistent with our 2010 comments, we agree that assumptions of risks and uncertainties should be evaluated and updated each reporting period to reflect all available information.

The proposed ASU would require use of an explicit, unbiased, probability-weighted estimate (“mean”) of future cash flows as of the reporting date expected to arise as the entity fulfills the contract for BBA contracts and the PAA liability for incurred claims. In the Basis of Conclusions (BC130-BC135) the guidance highlights this as a change from current guidance for both life (requiring projection changes for fluctuations in historical rates and excluding adjustments for parameter risks and pandemics) and non-life (distinctly different from the current “best estimate” approach based on an actuarial central estimate). However, the Basis of Conclusions does not provide information on how the measurement change will improve financial reporting and performance metrics for insurers. As a distinct change from existing industry-consistent measurement approaches, the proposed change is expected to result in significant system changes and impact the ability to compare future performance to historical results effectively. U.S. regulators identify that these changes would further widen the accounting differences between U.S. GAAP and SAP – a development that is undesirable by companies, investors and regulators. By reviewing the June 2013 U.S. Government Accountability Office (GAO) report ‘*Insurance Markets – Impacts of Regulatory Response to the 2007-2009 Financial Crisis*’ it is clear that the limited effects of the financial crisis on insurers can be attributed to the current statutory and regulatory framework. These performance results provide compelling evidence supporting the statutory accounting method – including actuarial projections and capital calculations – as valuable information for users. Unless there is desire for SAP financials to become a critical element for GAAP-user decisions, we advocate against measurement changes widening variations from SAP unless, and until, proposed changes are substantiated improvements.

### Changes in Estimates of Cash Flows (Question 13)

U.S. regulators agree with recognizing changes in expected fulfillment cash flows as better information regarding the amount, timing and uncertainty of the future cash flows is known. However, we believe in consistently applied concepts for the recognition of assets and liabilities when developing financial standards and the guidance in the proposed ASU is inconsistent with other recent FASB decisions:

- 1) Insurance Contracts Proposed ASU – Fulfillment cash flows used to determine the carrying amount – net asset or liability per portfolio of insurance contracts – shall reflect all available information at the end of the reporting period regarding the amount, timing and uncertainty of the remaining future cash flows (834-10-35-2). (Per the ASU, a forming hurricane which has yet to strike at the reporting date should be reflected in the expected cash flows for the reporting period.)
- 2) ACA Section 9010 Fee - Liability related to the Affordable Care Act (ACA) shall be recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable (720-50-25-1). Under this guidance a liability for the ACA fee would not be recognized at the year-end reporting date even though the fee amount is an expected cash outflow as of that date since it is based on the insurer’s reporting-year written premiums and the insurer has policies that cross-calendar year, policies they are required to renew, and/or is a going concern as they fully expect to conduct “qualifying health insurance” the very next day.
- 3) Credit Losses Proposed ASU - High-quality, performing assets measured at amortized cost will have “expected” credit losses recognized regardless of any actual expected negative changes to the asset’s performance (asset is performing per the contractual terms of the debt agreement), or whether the asset is impaired (the asset’s amortized cost is below fair value). (Proposed ASU 825-15).

With the three recent issuances/exposures, the FASB has recommended three different approaches for asset/liability recognition – all in standards that will be applied by insurance entities. If the expected cash flow model in the proposed insurance contract ASU is the desired approach, then changes are necessary to ensure all assets and liabilities in an insurer’s financial statements are reflected under the same approach. This would require changes to require recognition of the ACA fee as an expected cash outflow, and the need to eliminate expected credit loss recognition for performing, non-impaired assets held at amortized cost.

### Discount Rates and Discounting (Questions 14-20)

For contracts measured under the BBA (traditional long-term contracts), U.S. regulators continue to agree that the discount rate, when used, should reflect the characteristics of the insurance contract liability – (i.e., the economics of the insurance obligations in the jurisdiction including the nature, structure and term).

For contracts measured under the PAA (short-term contracts), discounting for reserves, other than those with fixed and reasonably determinable payments, will be a significant change from current accounting requirements. Although we agree with the concept of the time value of money, the proposed guidance in the ASU continues to add cost and complexity in completing financial requirements with limited benefits to users. In addition, insurers are not able to settle claims with policyholders on a present value basis, therefore the discounting of reserves will result in an inflation of equity that will report more dividend capacity than should exist. We support the change from the prior discussion draft to widen the discounting exception – allowing companies the ability not to discount portfolios of incurred claims when claims are expected to be paid within one year of the insured event. This change is clearly an improvement from the prior discussion document; however, is not sufficient to address our materiality concerns. For situations that will expand beyond the one-year timeframe, the guidance still requires insurers to document the immaterial impact – thus requiring discounting efforts to illustrate immateriality – for expected claim payment timeframes and market conditions that would produce immaterial results. We believe the “immateriality” practical expedient determinant should be expanded to reduce the costs necessary to implement. Also, as financial statement results should be prepared as consistently as possible, the guidance should

prohibit discounting for PAA contracts in all instances that meet the final (preferably longer than one-year) discounting exception.

U.S. regulators agree with the principles supporting the bifurcation and separate recognition of changes in expected fulfillment cash flows from variations in the discount rate. We agree that recognizing changes caused by the discount rate directly to net income leaves the process open to manipulation as even small changes in assumptions can have significant effects for long-term insurance. However, the proposed ASU is overly complex and likely to be a cause of confusion / misapplication within the financial statements. As an additional concern, the guidance does not require immediate loss recognition when discount rate changes result with an expectation that the assets backing liabilities are insufficient. Without this immediate loss recognition, favorable financial statements (surplus/retained earnings) will be presented, when in reality the company's discounted asset performance is insufficient to satisfy related future policyholder claims. With the fundamental need to provide investors and other users the ability to understand financial position and performance, we disagree with any proposed guidance that specifically identifies the potential overstatement of surplus/retained earnings (BC260), and reiterate that any such guidance should be considered unacceptable under U.S. GAAP.

As noted within our prior 2010 comment letter, U.S. regulators support a converged method for calculating discount rates. With the guidance in the proposed ASU we are concerned that liabilities and supporting assets will be valued using different methods potentially distorting financial results and conditions, and hindering the ease in which financial results can be compared.

#### Margin for Contracts Measured Using the Building Block Approach (Questions 21-27)

U.S. regulators support the FASB proposal for a single margin approach resulting with no gain recognized at initial measurement. We strongly believe it is not possible to reliably calculate and separate margin into "risk" and "contractual service margin" components, and the IASB proposal to allow such components is expected to result in financial statements completed with great uncertainty and higher risk for manipulation. To prevent an inaccurate financial statement presentation, we also agree that all losses at initial recognition should be recognized immediately in net income.

U.S. regulators support recognition of the margin ("expected profit" from the initial expected cash inflows over expected cash outflows) as the insurer is released from risk, including the settlement period. Within the guidance in the proposed ASU, if expectations in changes in cash flows are adjusted over time, those cash flow changes are recognized directly in net income, and are not used to adjust the margin unless the changes in cash flows are a result of a substantial contract modification. Although the systematic margin release over the risk period supports the concept of consistent measurement / matching principles, we identify that the immediate net income impact from changes in expected cash flows will provide opportunities for significant swings in operating performance.

The guidance is also unclear regarding situations when the margin is reflected immediately as revenue as expected outflows exceed inflows (834-10-35-22), but subsequent expectations reverse these cash flow projections (inflows exceed outflows). We do not believe the guidance allows for reestablishment of the margin – restoring the continued systematic recognition. However, without reinstatement, in subsequent reporting periods, financial statement users may not realize all "revenue" from a portfolio of insurance contracts has already been recognized.

#### Acquisition Costs (Questions 28-30)

U.S. insurance regulators agree with the consideration of incremental acquisition costs, defined in ASU 2010-26 as cash flows related to the insurance contract. We believe the application of this guidance has significantly improved the accounting for acquisition costs under insurance contracts and is superior to the guidance proposed by the IASB.

We disagree with the inclusion of acquisition costs in the margin with future expected cash flows. In accordance with the definition in 834-10-55-104, acquisition costs are costs directly related to the entity's selling efforts that result in insurance contracts in the portfolio. By this definition, these costs are known, and are not subject to

future fluctuations. Under the proposed ASU to include acquisition costs within the margin, users of the financial statements will be unable to differentiate between future cash flow expectations and previously expended costs. Although such acquisition costs are expensed immediately under statutory accounting, we understand the capitalization of these expenses under U.S. GAAP as costs incurred that produce future economic benefits. With the GAAP capitalization of these assets, a better presentation would be to separately identify these items within the balance sheet.

With again referring to the U.S. GAAP accounting for the Section 9010 ACA fee, we note that current guidance requires a separate “deferred cost” asset to be recognized for the ACA fee simultaneously with the liability recognition (Jan. 1) although nothing has transacted (no item received, no payment made) resulting in a future economic benefit. If the insurer ACA fee warrants asset recognition without incurring costs or noted future benefit, qualifying acquisition costs – as those costs have been incurred, resulting in insurance products that provide future cash inflows – should have separate asset recognition within the financial statements. Additionally, separate recognition allows users to identify the incurred costs from obtaining insurance contracts, and the cash flows (asset/liability) expected from covering insured risks.

#### Insurance Contract Revenue (Questions 31-34)

U.S. regulators strongly agree that information on insurance revenue and expenses should be explicitly detailed within the financial statements. Per our 2010 comment letter, we disagreed with the margin presentation approach as information regarding premiums is a key performance measure for insurers. Furthermore, we identified that failing to include information regarding premiums, claims expenses, claims handling expenses, acquisition costs and other expenses in the measurement of insurance contracts in the statement of income will significantly impair its usefulness for all financial statement users. Although the current proposal is an improvement beyond the original margin presentation approach, the inclusion of key benchmarking information is still necessary within the financial statements and must be retained.

We do not object to the exclusion from revenue/expense amounts received from an entity that the insurer is obligated to return regardless of whether an insured event occurs. (*We reiterate the variation in definitions with the IASB of this guidance as the “distinct investment component”.*) In addition to excluding from revenue/expense these amounts, the guidance should also specifically exclude all income and expenses related to claims, losses, premiums and other amounts received or paid on behalf of uninsured Administrative Service Organizations or uninsured Administrative Services Contracts. Under such contracts, the reporting entity is an insurance administrator (premium collector / claims processor) but has no loss or liability caused by insurance claims.

For contracts measured under the PAA (short-term contracts), the discounting requirements, for contracts without fixed and reasonably determinable payments, will be a significant change adding cost and complexity to the financial statements and the calculation of revenue. We believe the guidance should further expand the discounting exception and explicitly prohibit PAA discounting when the discounting exception is met.

For contracts measured under the BBA, we support recognition of the margin as the insurer is released from risk, including the settlement period. However, we believe the guidance is unclear in situations when the margin is recognized immediately as revenue as expected outflows exceed inflows (834-10-35-22), but subsequent expectations reverse these cash flow projections (inflows exceed outflows). We do not believe the guidance allows for reestablishment of the margin – restoring the systematic recognition. Without reinstatement, in subsequent reporting periods, financial statement users may not realize all “revenue” from a portfolio of insurance contracts has already been recognized.

#### Participating Contracts (Question 35)

U.S. regulators do not object to the guidance for participating contracts. We agree that the process should be limited to participating features that pass performance of the underlying items to policyholders through contractual determinants and that exclude “participating” features that allow an entity to limit the performance results passed through to policyholders.

### Reinsurance (Questions 36-37)

U.S. regulators agree with prohibiting immediate gain recognition for all insurance contracts – regardless if the insurance contract is direct or assumed by the reporting entity and regardless if the risk is retained or ceded. We also agree with the provisions to recognize fulfillment cash flows (including the ceded premium) using assumptions that are consistent with the underlying insurance contract without reference to the underlying contract margin.

We strongly agree with the exclusion of nonperformance risk by the reporting entity when determining their fulfillment cash outflows. The consideration of nonperformance risk by the cedent for reinsurance recoverables is acceptable (as we agree with the impairment of uncollectible assets), but we distinctly disagree with the use of the proposed guidance on expected credit losses (825-15) for establishing nonperformance risk. Under that guidance, “an estimate of expected credit losses shall neither be a worst-case scenario nor a best-case scenario. Rather an estimate of expected credit losses shall always reflect both a possibility that a credit loss results and that no credit loss results”. With the proposed guidance in 825-15, an allowance for nonperformance risk would always be required for expected reinsurance credit losses (as the best-case scenario is prohibited), which would not take into account other facts and circumstances in determining whether such allowance is appropriate (e.g., collateral held, company experience, recoverable amounts past due and/or in dispute).

### Contract Modifications (Question 39)

U.S. regulators agree that with substantial contract modifications the entity shall derecognize the original insurance contract and recognize the new modified contract. We also agree with the intent of the FASB to prevent manipulation of earnings by allowing the original remaining margin to be recognized in income at the time of contract modification. We agree that by using the price that would have been charged for the current contract in comparison to the expected cash outflows, the appropriate margin for the substantively revised contract can be determined and recognized over the new risk period as appropriate.

### Presentation (Question 40)

As noted in the Basis for Conclusions, the objective of the amended guidance is to improve, simplify and enhance the financial reporting requirements for insurance contracts and to provide investors with decision-useful information. Under the proposed guidance, information reported on the face of the financial statements will be limited (net asset/liability on portfolio basis), distinctly different from existing U.S. GAAP (which focuses on premiums and claims expenses/reserves) and provide insurers with optionality on the information presented on the face of the financial statements. It is our opinion that in terms of consistency, comparability and transparency, the revised presentation will not result in improvements to investors or other users with the ability to understand the activities, and ultimate financial position, for companies that issue insurance contracts.

### Disclosure (Question 41)

U.S. regulators support the long-standing position that disclosure should not be considered an adequate substitute for reporting on the face of the financial statements. Disclosures should supplement reported key performance information, and not be the source of such detail. We are concerned with the limited amount of information readily proposed to be available on the face of the financial statements, with the inclusion of specific, voluminous disclosures. We encourage reconsideration of the financial statement presentation, focusing on the needs of investors and other users, as we suspect this assessment will demonstrate the need for more information consistently presented in the financial statements.

As previously stated, the NAIC strongly supports the inclusion of the undiscounted claims development as it is critical information allowing users to understand the insurer’s ability to properly underwrite and anticipate claims. With this new disclosure, which can be completed by insurers without cost or complexity as it is already required under statutory accounting principles, users of U.S. GAAP financials will be able to readily obtain this key performance information without the need to acquire the specialized statutory financials.

Costs and Complexities (Questions 47-48)

As initially stated, our comments predominantly represent the U.S. regulator viewpoint as financial statement users. However, with our role to monitor and promote insurer financial solvency, we must stress concerns on the cost and complexity of the proposed ASU as these aspects will be significant detrimental factors for insurers:

- The need for personnel and systems to execute the proposed ASU will be very expensive. The total incremental costs are difficult to determine with accuracy, but costs will likely be greater than expected:
  - New stochastic modeling systems will have to be developed and maintained.
  - More and duplicative accounting and actuarial resources will be required on an ongoing basis to apply the proposed guidance, particularly with assumptions that statutory reserving methodologies will not change, and investors will still be interested in unearned premiums and losses. More information technology resources will be required to set up and monitor the new processes and track the multitude of additional variables required by the proposed guidance.
- Specifically for issuers of short duration contracts, the requirement to discount cash flows is a primary item that will require substantial cost and provide little benefit. Issuers of short-duration contracts typically do not have the systems in place to perform discounting on the scale required by the proposed guidance, nor do these issuers always have the expertise to develop the adjusted yield curves for the various portfolios. Additional actuarial services will have to be obtained to complete the new reserving process. Currently, reserving processes focus on developing an actuarially based estimate of the ultimate settlement value of incurred claims whereas the proposal would require an estimate of the incurred claims using unbiased probability weighted cash flows which generally involves the introduction of stochastic modeling techniques typically not employed for reserve estimation. The proposal would also require an estimate of the expected timing of the payments for purposes of the required discounting of incurred claims, with limited exceptions. The proposal would result in existing claim reserve estimation processes being significantly modified to incorporate the shift from producing an ultimate settlement value of incurred claims to a current value of incurred claims.
- Many small companies have limited personnel responsible for the accounting function and do not have the financial or human resources to manage a reporting and IT system change of this magnitude. Wholesale changes in accounting require a significant investment in time and financial and human resources. Utilizing information known from large insurers beginning to report under U.S. GAAP (from reporting only under SAP) the cost to implement was noted as being in the hundreds of millions. The cost to implement the proposed ASU, which is drastically different from current U.S. GAAP and SAP, is expected to be more.

Thank you for your review and consideration of this comment letter. Should you have any questions, please contact me at 614-728-1071, or NAIC staff Julie Gann (816-783-8966).

Sincerely,



Dale Bruggeman  
Chair, NAIC Statutory Accounting Principles Working Group