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File Reference No. 2013-290: Proposed Accounting Standards Update - Insurance Contracts (Topic 834)

Members of the Financial Accounting Standards Board,

I am an Associate of the Casualty Actuarial Society and a member of the American Academy of Actuaries. I have nineteen years experience working in the actuarial profession. I have reviewed the exposure draft and have several serious concerns. In this letter I am addressing only the impact of the exposure draft on property-casualty insurance.

I strongly recommend that the Board reject the guidance contained in the exposure draft. Current guidance should be retained.

There are several reasons why the proposed guidance should be rejected, but the most critical issue is that, in my opinion, it is not an improvement over current GAAP. Decision useful information and comparability of performance between contract issuing entities will both become difficult to determine as they are submerged in complex calculations and subjective assumptions. There is a danger that, lacking confidence in the guidelines, stock analysts will find property-casualty insurance to be an undesirable sector for capital investment.

The requirement to discount cash flows and its associated obligation to create portfolios of contracts to which discounting would be applied are the principle changes which significantly diminish decision useful information and performance comparability relative to the current GAAP guidance. Discounting is a valid concept and has its place in various valuation and economic capital exercises, but its application to the uncertain and variable cash flows of property-casualty insurance contracts is an exercise best undertaken by financial users who can select their own assumptions and their own measurement objective. Requiring management to perform the discounting exercise greatly increases the subjectivity of the resulting liability estimates and will require a tremendous amount of disclosures (and work) to attempt to compare period-to-period performance. Other than the prescribed exercise for determining federal income taxes, which most companies view as simply an income recognition timing issue and not a performance measure, the property-casualty industry has little experience determining an appropriate duration matching yield curve. Leaving it to entities to apply the subjective bottom up or top down approach would surely result in a range of discount rates for any reporting period. Even if a specific rate were mandated, the meaning of the discounted values is difficult to discern as it would certainly not be comparable to an entity valuation exercise. It would be far better to continue liability measurement on a nominal basis and leave discounting to users.

Grouping contracts by portfolios is the second issue that works against comparability. The restrictions on portfolio construction provided by the guidance tend to encourage granularity. A very strict interpretation of the guidance could lead to portfolios that have very little actuarial credibility for loss reserving purposes, be it a discounted cash flow or nominal projection. Granularity could also lead to a tremendous number of portfolios, especially if how often new portfolios may need to be created is considered (annually, quarterly, monthly?). Statement preparers would face a daunting task of determining the definition and timing of portfolio creation (not to mention maintenance) and users would face an even more daunting task in trying to interpret and classify portfolios emanating from a large number of preparers. A final unresolved issue concerning portfolios is that traditional calendar-accident year aggregations of premiums and losses do not match cash flows from identical contracts. Requiring a different aggregation approach in order to accomplish contract cash flow matching would be a very, very significant change for preparers and users alike.

The most actuarially troubling issue with the proposed guidance is the liability measurement objective. Targeting the "unbiased probability weighted estimate", whether by using discounted cash flows or the normal ultimate nominal approaches used by most property-casualty actuaries implies that there is no consideration of uncertainty in the liability estimate. Just as all actuaries know ignoring uncertainty and targeting the mean in insurance ratemaking is doomed to failure, likewise discarding uncertainty in liability estimates is not a wise actuarial or business practice. Insurance history is replete with many companies whose weak pricing and reserving strategies, who "thought" their estimates were more "certain" than they were, led them to insolvency. It is far better to retain the link with statutory accounting and encourage sound reserving practices (and solvency) rather than ignoring uncertainty.

A final somewhat minor issue deserves mention. The proposed guidance would require the liability for remaining coverage to be earned proportionally to the expected incurred loss pattern. While sensible, the matching of the earning and incurred loss pattern for contracts whose premium is completely earned in one year probably adds less value than the costs of changing the standard industry practice of earning premium uniformly over time.

Thank you for the opportunity to comment on the exposure draft.

Sincerely,

Kristin Brown

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