



August 23, 2006

The Dow Chemical Company
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Technical Director
Financial Accounting Standards Board
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LETTER OF COMMENT NO. 15

Re: File Reference No. 1325-100 – Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting

The Dow Chemical Company appreciates the opportunity to respond to the Invitation to Comment (ITC) “Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting”.

The principle issue in this ITC is whether bifurcation of insurance contracts into insurance and deposit components would improve the understandability and decision usefulness of the financial statements. We do not believe that understandability and decision usefulness will be improved with bifurcation of insurance contracts; we believe that bifurcation would cause the financial statements to become more complex and potentially misleading. The following key factors weigh into our opinion:

- Risk transfer guidance in Statement 113, when properly applied, is working appropriately for reinsurance transactions. This risk transfer guidance could be expanded to apply to insurance contracts for corporate policyholders and insurers.
- Bifurcation would not increase the user’s understanding of the financial statements. The bifurcation of reserves into insurance and deposit components does not lead to better understanding of the underlying risk and risk limiting factors within the contracts.
- The bifurcate decision would be influenced by numerous assumptions, adding more variability and questions as to what is being represented in the underlying financial statements. The number of factors involved in the bifurcation decision will increase inconsistencies in treatment, not only among companies but potentially among individual, similar insurance contracts within the same company. It is conceivable that the bifurcation analysis could result in significantly different accounting treatment between the policy holder and insurer for the same arrangement.

The cost of bifurcation would well exceed the benefits. As stated above, we do not believe that bifurcation improves the decision usefulness of the financial statements, thus we see no benefits to a change, however costs would increase significantly.

- Proposed bifurcation Approach B would lead to bifurcation analysis of essentially all corporate policies and reinsurance policies, as none would meet the proposed single risk, unequivocal risk transfer test. However these contracts may transfer a level of risk that is inherently no different than multiple single risk policies.

- Once bifurcated, the cost of calculating and re-evaluating the deposit-related balance for each contract at the end of each reporting period would be both significant and impractical. This applies both to the policy holder and the insurer.
- Assuming there is no immediate corresponding change to statutory regulations, the significant difference between GAAP and statutory regulations will result in increased costs to insurance companies to track two widely different accounting methods.
- The potential changes raised in the ITC may require significant costs for system development or enhancement.

We suspect that recently reported issues with misstatements are a result of misinterpretation or misapplication of current guidance, and wholesale changes to accounting for insurance are not necessary.

Responses to the individual issues raised in the ITC are attached.

Sincerely,



William H. Weideman
Vice President and Controller

Issue 1: Does the IFRS 4 definition of insurance contract identify insurance contracts and sufficiently distinguish those contracts from other financial contracts? Does the GAAP definition of insurance risk identify and separate that risk from other risks such as financial risk? Do the descriptions of finite insurance and reinsurance contracts, including the risk-limiting features, identify those contracts? How could the definitions and descriptions be improved?

The IFRS 4 definition of insurance contract does not adequately identify insurance contracts and, therefore, is not an improvement over the current GAAP definition. The indemnification terminology (as opposed to compensation) more appropriately correlates to the way corporate and reinsurance agreements are worded. The use of the term 'event' in the proposed definition causes additional questions. An 'uncertain future event' definition does not allow for an unknown or uncertain past event, unless the 'event' definition includes the presentation of a claim, or unexpected development on a known occurrence. This definition could be interpreted to exclude replacement coverage as an insurance contract. For example, product liability insurance coverage relating to a newly discovered past event would be precluded from consideration.

Yes, the GAAP definition of insurance risk sufficiently separates insurance risk from other risks. This definition of insurance risk, unlike the above definition of insurance contract, includes unknown or uncertain past events, which implies that replacement coverage or coverage of development on a known claim could be considered insurance risk. This definition also appropriately includes reinsurance contracts.

There can be insurance and reinsurance contracts with risk limiting features that easily pass the current risk transfer test. The term 'limits', as used here, is too broad. Many standard insurance contracts include aggregate limits or per occurrence limits. Would these types of contracts really be considered finite insurance? At what point do you draw the line between finite and non-finite contracts? These descriptions imply that all reinsurance agreements transfer a restricted amount of insurance risk, and would thus receive bifurcation. This imposes an undue burden on the reinsurance industry, especially given that understandability and decision usefulness of financial statements would not be improved.

Issue 2: Can the Statement 113 risk transfer guidance for reinsurance contracts be applied by corporate policyholders and insurers for determining whether an insurance contract transfers significant insurance risk? If not, how can the Statement 113 guidance be modified or clarified to apply to insurance contracts?

Yes, the current Statement 113 risk transfer guidance can be applied to corporate policy holders and insurers to determine whether an insurance contract transfers significant insurance risk.

Issue 3: Does classifying an entire contract as insurance or bifurcating that contract into insurance and deposit components provide more understandable and decision-useful information? Which qualitative characteristics most influence your decision? Which approach more faithfully represents the economic substance of the contract? Why?

No, we do not see an increase in the quality of information in attempting to split an insurance contract into the two pieces.

We believe that bifurcation of insurance contracts would significantly reduce both relevance and reliability. The bifurcation would not give the reader of the financial statements any better information to predict future cash flows. It is conceivable that the bifurcation analysis could result

in significantly different accounting treatment between the policyholder and the insurer for the same arrangement. We believe the use of potentially vastly different assumptions by each associated company in the bifurcation process would reduce the reliability and comparability of financial statements. We question whether policyholders would even have access to the data needed to make the assumptions.

Accounting for an insurance contract as either insurance or deposit, without bifurcation, more faithfully represents the economic substance of the contract. The contract is entered into as an entire agreement. It is inappropriate to assume that the parties would be agreeable to enter into pieces of the contract separately. Because the agreement is taken as a whole, the accounting should correspondingly be handled as one transaction, and not bifurcated.

Issue 4: The flowchart suggests a sequence for analyzing contracts that integrates current insurance accounting guidance with a hypothetical bifurcation analysis. Do you believe that the sequencing and integration are appropriate? What changes would you propose?

The sequencing appears appropriate; however the unequivocal risk transfer test guidance outlined is unreasonably restrictive. The pooling or spreading of risks is an important function of insurance. The unequivocal risk transfer test guidance forces typical insurance contracts for corporate policyholders into bifurcation. The flow chart should stop with the question 'does the contract meet the Statement 113 risk transfer test', with yes resulting in insurance accounting and no resulting in deposit accounting (consistent with current guidance).

For example, if the unequivocal risk transfer concept as outlined is used as a test for bifurcation, a direct writer of individual policies may be forced to account for the same risk using two different methods. The direct individual risk would be accounted for as insurance, and if a portion of that risk is ceded to a reinsurer, the reinsurance would be bifurcated and a portion treated as deposit. Inherently there is no change in the underlying risk being insured/ceded, thus the difference in accounting treatment appears inconsistent. Further, it will reduce the comparability between contracts that are economically similar.

Issue 5: Do you agree with the characteristics identified for contracts that do or do not unequivocally transfer significant insurance risk? If not, why not? Should other characteristics be added? Are the examples in Appendix B representative of the discussion in paragraphs 57-59?

The definition for unequivocal risk transfer is unreasonably restrictive, especially from the viewpoint of a corporate insured, corporate insurer or reinsurance company. The unequivocal risk transfer test guidance forces typical insurance contracts with clear risk transfer into bifurcation. Based on this definition, no reinsurance policy could unequivocally transfer risk. For captive corporate insurers, lack of coverage availability in the open market may force a policy into bifurcation due to lack of availability of market-equivalent level of premium for comparison.

It is illogical to account for pools of risk differently than individual one person, one risk contracts. For example, if an insurance company writes 25 individual policies for 25 autos, versus one policy for a fleet of 25 autos, there is no difference in the underlying risk, however a difference in the accounting treatment is being proposed. This difference in accounting would not make the financial statements clearer to the reader.

Yes, the examples in Appendix B are representative of the discussion in paragraphs 57-59, however as stated above, we don't believe the discussion in paragraphs 57-59 is reasonable.

Issue 6: Do you think the characteristics described in paragraph 58 for unequivocal insurance contracts are an improvement over the exemption from cash flow testing in paragraph 11 of Statement 113 (summarized in paragraph 37(c) of this Invitation to Comment)?

No. The concept of unequivocal insurance contracts is incorrect and does not consider the concept that insurance, by nature, is the pooling of risk. Using the above example of an insurance company writing 25 individual policies for 25 autos, versus one policy for a fleet of 25 autos, there is inherently no difference in the underlying risk to the insurance company, thus both situations should be accounted for in a similar manner.

Issue 7: Do you prefer Approach A or Approach B for identifying contracts subject to bifurcation? Why? Do you believe that another approach would be superior? If so, how would you describe that approach? Would your preferred approach be operational? Would it make financial statements more decision useful?

We do not believe that bifurcation of insurance transactions makes the financial statements more decision useful. We believe that bifurcation would add complexity and confusion to the financial statements. The current FAS 113 risk transfer testing (which could be expanded to apply to insurance contracts), with resulting accounting treatment as either all deposit or all insurance is more appropriate. As a result, we do not agree with either approach.

Issue 8: Should the criteria for bifurcation be different for insurance contracts and reinsurance contracts? Why? If yes, what differences would you suggest?

The criteria can be the same for insurance contracts and reinsurance contracts. However the criterion for bifurcation needs to be narrower, analyzing the true finite transactions. Reinsurance contracts and pool/group type of insurance contracts by nature will have a higher dollar-trading component than the type of insurance contracts outlined by the test for unequivocal risk transfer because of the nature of pooling of risk. The criterion for bifurcation needs to be reasonable enough that insurance and reinsurance contracts which pass the FAS 113 risk transfer test are accounted for as insurance.

Issue 9: Which of the methods identified in this Invitation to Comment for bifurcating insurance and reinsurance contracts do you believe has the most conceptual merit? Please explain. Please describe any additional bifurcation methods that you believe should be considered. Would corporate policyholders encounter unique implementation problems in applying any of the methods discussed in this Invitation to Comment?

Although we do not believe bifurcation is a preferable approach, if forced to choose a method, the proportional method appears to achieve a more representative result than the expected payout and cash flow methods at attempting to identify the risk transfer portion of the contract through examining the risk retained by the policyholder before and after the insurance contract.

The expected payout method process relies on factors for which there are no clear answers. The variable input factors will result in potentially variable results. If the premium charged for a policy is based on historical results, all premiums could potentially be accounted for as deposit.

A component of insurance risk is timing risk. Given the timing risk of cash flows, the application of the cash flow yield method would have inherent variability.

Issue 10: Would data availability limit the development of any of the bifurcation methods discussed in this Invitation to Comment? To what extent are the models that would form the basis for these methods used to underwrite and price products? Would data availability (or lack thereof) affect only certain insurance forms, products, or lines of business? If so, which ones and why?

Yes, data availability would limit the implementation of all bifurcation methods. Additional resources to implement these methods could not be obtained without undue cost and effort. This would also be a significant change in data collection for corporate policyholders. It is not known how a corporate policy holder would quantify some of the risk limiting features in large corporate policies such as aggregate limits and per occurrence limits. The manuscript policy form makes it more administratively difficult to apply the methodology because the policies are not standard and each policy must be analyzed individually. For treaty reinsurance the necessary data for analysis is not readily available. Companies would be forced to rely on the ceding companies to provide the data (assuming they were willing). This would be a huge administrative burden, both on the part of the corporate policy holder and the corporate insurer/reinsurer. All policies would need to be analyzed and tracked individually.

For long tail business with occurrence policy form, this tracking would go on for years for lines such as product liability and pollution. Not only would the deposit/risk pieces be required to be tracked by policy, they would also need to be tracked by legal entity, increasing the amount of effort exponentially. Considering the number of coverage lines, the policy/entity combinations, and the long tail nature of the coverage, we believe this will significantly increase the resources necessary to track insurance policies, both for the insurer and the policy holder.

Issue 11: In view of the IASB's project on insurance contracts, should the FASB be considering bifurcation of insurance contracts based on transfer of insurance risk?

The FASB's issuance of new guidance would likely create more differences between US GAAP and IFRS. If the goal is to bring the two methodologies closer together, it would make more sense to make guidance changes on this issue only once.