Endurance

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LETTER OF COMMENT NO. 36

November 16, 2007

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Dear Director:

Endurance Specialty Holdings Ltd. ("Endurance") appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB") Invitation to Comment ("ITC"), *An FASB Agenda Proposal: Accounting for Insurance Contracts by Insurers and Policyholders, Including the IASB Discussion Paper,* Preliminary Views on Insurance Contracts (issued 08/02/07).

Headquartered in Bermuda, Endurance, through its operating subsidiaries, is a global provider of property and casualty insurance and reinsurance. It conducts business through its offices in Bermuda, the United States and the United Kingdom. Endurance, which commenced operations in late 2001, reported approximately $1.8 billion in written premiums in 2006 and is traded on the New York Stock Exchange.

Question 1: Is there a need for the FASB to comprehensively address accounting for insurance contracts? Why or why not?

a. What aspects of existing U.S. GAAP accounting for insurance contracts could be improved or simplified and how pervasive are the issues?
b. How important is the development of a common, high-quality standard used in both the U.S. and International Financial Reporting Standards ("IFRS") jurisdictions?

Response 1: We do not believe there is a need to comprehensively address the accounting for insurance and reinsurance contracts. We believe the existing guidance is sufficient in most areas. Two areas we believe would benefit from additional guidance, but not a comprehensive rework of the existing guidance are (1) further clarification of the risk transfer requirements included in SFAS No. 113 and (2) clarification of how these risk transfer requirements apply to insurance contracts. It is our understanding that both of these issues are currently under review by the FASB.

We also believe that it is very important that a common standard be developed for use in both U.S. and IFRS reporting. We would strongly encourage the FASB to work jointly with the IASB as it pursues development of its insurance standard.

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Question 2: Are the preliminary views expressed in the IASB Discussion Paper a suitable starting point for a project to improve, simplify, and converge U.S. financial reporting for insurance contracts? If not, why not?

a. Do you believe the preliminary views would be feasible to implement? If not, what aspects of the preliminary views do you believe could be difficult to apply and why?
b. Are there alternatives to improve or simplify U.S. financial reporting for insurance contracts that you would recommend? What would be the benefits of those alternatives to users of financial statements?

Response 2: We do not agree that the preliminary views expressed in the IASB Discussion Paper ("DP") are an appropriate starting point for any purpose. As noted in response to Question 1, we believe that existing FASB guidance is sufficient in most areas a should not be dis-regarded as a suitable starting point. We do not believe the principle concepts included in the DP are feasible. We have included our comment letter to the IASB, which outlines our primary objections to certain of the concepts put forth in the DP, as an attachment to this response.

We support efforts at both the FASB and IASB to include insurance accounting within a broader, non-industry specific accounting framework. However, we also believe that there exist characteristics unique to insurance and reinsurance that require specific consideration, especially with respect to measurement and valuation. As more fully discussed in our comment letter to the IASB, these considerations arise primarily from the fact that a ready market does not exist in which to obtain objectively verifiable, market consistent valuation information. We strongly encourage the FASB and IASB to fully consider associated implications, including lack of consistency, comparability and auditability, potential for manipulation, and the complexity which will result for users of financial statements.

Question 3: Is there a need to address accounting by policyholders in an insurance contracts project? Why? If yes, should accounting by policyholders be addressed at the same time as the accounting by insurers? Can or should that wait until after the accounting by insurers is completed?

Response 3: We do not believe that a comprehensive change to existing insurance and reinsurance accounting guidance is required. We also do not believe a comprehensive project to address accounting by policyholders is necessary, however, we would support a FASB project to define the manner in which existing accounting guidance regarding insurance and reinsurance accounting should apply and extend to policyholders of insurance contracts. If the FASB does not pursue comprehensive changes to existing insurance and reinsurance accounting guidance, we believe such a project could be currently undertaken. If comprehensive change to existing guidance is pursued, we believe it most appropriate to first address any changes to insurance accounting, including any changes which might arise as a result of FASB and IASB convergence efforts for insurance contracts.

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Question 4: How would you address the interaction between the accounting for insurance contracts and the FASB's other projects on the conceptual framework, revenue recognition, liabilities and equity, financial instruments, and financial statement presentation? Are certain projects precedential?

Response 4: We believe that any comprehensive project regarding insurance accounting should (1) only be undertaken once the other FASB projects noted above are completed, as they address concepts fundamental to insurance and (2) be undertaken jointly with the IASB with the goal of convergence of FASB and IASB principles with respect to accounting for insurance contracts.

We appreciate the opportunity to provide our comments and our views relating to this ITC.

Sincerely,

William Babcock
Chief Accounting Officer
Endurance Specialty Holdings Ltd.

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16 November 2007

Mr Peter Clark
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Re: International Accounting Standards Board ("IASB") Discussion Paper "Preliminary Views on Insurance Contracts"

Dear Mr Clark,

Headquartered in Bermuda, Endurance Specialty Holdings Ltd. (Endurance) is a global provider of property and casualty insurance and reinsurance. Endurance conducts its business through its operating subsidiaries located in Bermuda, the United States and the United Kingdom. Endurance, which commenced operations in late 2001, reported approximately $1.8 billion in written premiums in 2006 and is listed on the New York Stock Exchange.

Endurance welcomes the opportunity to comment on the IASB's Discussion Paper "Preliminary Views on Insurance Contracts" ("DP"). We fully support the IASB's aim of establishing a consistent method of accounting for insurance contracts across different jurisdictions. However, we believe this will only succeed if all other interested parties, including the Financial Accounting Standards Board ("FASB"), actively participate in its development and ultimately adopt the standard. Further, we agree with the IASB's approach in that any successful standard must be principals based and not overly prescriptive.

Whilst Endurance agrees with certain aspects of the theoretical approach as set out in the DP, we are concerned that a number of primary objectives for any such standard will not be met by the DP in its current form:

- **Transparency** - for general insurance and reinsurance companies, the users of the financial statements will be required to understand significantly more complex and sensitive valuation methodologies, additional parameters which significantly impact such valuations and how the preceding impact the financial results of the business. Additionally, without significant changes to the DP, especially with respect to the current exit valuation methodology, the ability for the average user to understand financial results and comparability of financial results between companies will be substantially more difficult, even with expanded disclosures..
- **Volatility** – the theories outlined within the DP, especially related to current exit value, will create additional inherent volatility in the reported results for any given insurer which may not be indicative of financial performance and may have an inappropriately negative impact to the capital markets, rating agencies and regulators. We would encourage the IASB to consider further the appropriateness of adding such volatility, which may be driven largely by assumptions used in complex

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valuation calculations for which there is little objectively verifiable data, and actively engage with a cross section of these communities to ensure that their views are fully taken into account.

- **Not truly reflective of how we currently manage our business** – the DP disregards key performance indicators, such as combined ratios, which are currently used by both the industry and investor community and widely understood by all.
- **Cost: Benefit** – a field test should be undertaken to ensure that the proposals are both relevant, decision useful to financial statement users, and can be practically and cost effectively undertaken by the industry.

Our remaining responses are limited to specific themes of the DP, as they relate to general insurance business, and that are of particular concern to us:

Current Exit Value:
Endurance does not conceptually disagree with the general principal of valuation and the three building blocks on which it is based i.e. cash flow, time value of money and risk margins. Indeed this approach is similar to the method employed in pricing risk internally (i.e. current entry value). In fact, depending upon the parameters required under the DP to determine current exit value, these two values should be similar if not the same at the date the contract is entered into. We do not believe that current exit value provides an objective basis for subsequent liability measurement as there exists no ready marketplace to easily and readily price such risks. Accordingly, little or no independently identifiable and verifiable information is available to accurately determine current exit value. We believe the diversity in valuation inherent in the current exit value approach will significantly impair the comparability of financial results and provide companies the opportunity to manage financial results by modifying valuation assumptions that can not be objectively verified. We also believe that the current practice of establishing liabilities at the current best estimate of ultimate cost is appropriate, prudent, substantially more objective and verifiable, and should continue to be the required basis for establishing estimates of insurance and reinsurance liabilities for losses.

To appreciate the potential for manipulation it is useful to examine the assumptions that Insurance companies currently use to price risk at inception. These include inflation forecasts, loss payout patterns, individual margin requirements, the diversifying nature of risks to an individual company's risk portfolio, interest rate and volatility assumptions. These variables will provide, in a material way, certain of the assumptions subsequently used to determine current exit value. Focusing on a single parameter, such as the estimated timing of loss payout, illustrates the potential for material manipulation, largely resulting from the use of unverifiable assumptions. For example, assumptions regarding the timing of loss payments in long-tailed lines of business, such as medical malpractice, environmental liability and other casualty lines, can result in dramatic differences in the recorded liability due to discounting under the current exit value approach. This is true even though the ultimate amount of losses to be paid remains unchanged. Changes in assumptions, which may result in the revaluing of a liability by very material amounts due to the loss payout period associated with these classes of business, may be based on such unverifiable assumptions as a change in a company's view regarding the legal, regulatory or political environment surrounding a particular issue, future inflation, claims litigation and settlement practices, etc. We believe that the material liability valuation differences which will result from varying unverifiable assumptions provide an unacceptable level of potential for manipulation and significantly hinders comparability of financial statements. Even if disclosure requirements provide information related to such changes, we do not believe that general financial statement users will possess sufficient objective information to adequately assess the reasonableness of such assumptions.

Initial Profit:
We do not believe that it should be possible to report initial day one profit as, we believe, would often result using the "current exit value" approach outlined in the DP. Profit embedded within insurance contracts is more realistically linked to the "risk period" over which that contract is exposed to loss and not merely the inception of the contract. Therefore any embedded profit ("risk margin") should be recognised as the "risk period" expires. We also believe that this issue will present companies with the opportunity to manipulate results as little objective and verifiable information is available to corroborate assumptions which have a material impact on the determination or generation of initial day one profit.

Credit Characteristics of an Insurer:
We disagree that an insurer's credit standing should play any significant part in the valuation of its insurance liabilities. Such an approach inappropriately provides a risk bearing entity with financial benefits in the event of credit deterioration, i.e. an insurer's declining credit position would increase the entity discount rate and create a profit for the period in question by reducing the liabilities previously recognised by that entity.

Additionally it disregards the market reality that risks are often placed with companies of differing credit position at exactly the same financial terms.

The use of the insurer's credit standing also ignores collateral and industry guaranty funds. Where these are in place, the variation in credit standing of the entity is of limited concern to the beneficiary of the contract to the extent that the collateral or industry guaranty covers the liabilities in question. In these cases it would appear perverse to apply a variation in valuation of the liability.

It is also difficult in practice to accept the position of the volatility of a given insurer's credit downgrading (or indeed upgrading) would have on the profit and loss account in a given year and the understanding that a user of the accounts would have of this.
Finally, buyers of insurance currently do use other sophisticated measures of assessing credit worthiness in establishing a trading relationship with a given insurer in addition to its financial statements.

Life and General insurance models:
A "one size fits all" approach to insurance is not appropriate. Life and General insurance businesses have characteristics which are materially divergent and require differing approaches to account for them. This can clearly be seen in two areas of the DP, "service margins" and "unbundling", which have relevance for Life business but make little sense for General business. We would encourage the IASB to develop different models for Life and General business. These models could use the same basic building blocks but differ in

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detail where relevant. Field testing would aid in the objective identification of these differences.

Disclosure:
The DP introduces a number of new concepts to insurance accounting. We believe that, as a result of the fundamental flaws in the DP approach detailed above, disclosure can not and will not be capable of providing information necessary for financial statement users to reasonably understand or corroborate the valuation assumptions and the impact of these assumptions on financial statements. We also feel that, provided the DP is revised in response to the observations and deficiencies noted above, comprehensive disclosure requirements should be an integral of the revised standard.
Other factors for the IASB to consider:

Audit:
We would encourage the IASB to consider, along with industry audit practitioners, the auditablity and standard of audit evidence requirements of the preparer of financial statements prepared using the concepts outlined in the DP. This may prove especially challenging where there is no readily identifiable and verifiable market parameter for a given variable used in their preparation. Under the current DP, it is highly likely that audit costs will increase significantly given the increased subjectivity that will be inherent in reported financial statements.

Solvency II:
Whilst we acknowledge that Solvency II is not relevant for non-EU domiciled companies; we encourage the IASB to continue to work to ensure that Solvency II and IASB accounting concepts converge as much as possible. This will ensure that the practical effort and cost burden on companies in satisfying both stakeholders is limited.

Tax:
Many tax authorities around the World, including the HMRC in the United Kingdom, use the financial information as presented in the profit and loss account to form the basis of tax calculation. If the proposals set out in the DP are adopted there are potential consequences of utilising theories that may not be acceptable to tax authorities (e.g. discounting, changing parameter selection year on year for the same given business which would lead to deceleration or acceleration of profit recognition) that may lead to more complex tax calculations and a more volatile tax rate as presented on the face of the profit and loss account. We would encourage the IASB to further consider the impact of the DP in this area.

Thank you for this opportunity to express our opinions to you regarding this matter.

Yours sincerely,

Simon Minshall
Chief Financial Officer
Endurance Worldwide Insurance Ltd.

William Babcock
Chief Accounting Officer
Endurance Specialty Holdings Ltd.