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November 30, 2010

Mr. Russell Golden, Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856
By E-Mail: director@fasb.org

File Reference No.: 1870-100

Dear Mr. Golden:

The National Association of Mutual Insurance Companies comprises approximately 1,400 mutual insurers doing property casualty-business in the United States and Canada. Our 1,300 insurers operating in the United States, ranging from the very smallest to the very largest property-casualty insurers, write more than 37 per cent of such insurance business done in this country.

It is appropriate for us to rehearse the fact that our mutual members are creatures of statutory accounting as maintained by the NAIC and states, rather than GAAP. Statutory accounting used by insurers may be described as a system that is separate from but parallel to GAAP. Statutory accounting's distinguishing features, relative to GAAP, are that it is somewhat more conservative than GAAP, gives more weight to the balance sheet, and is otherwise tailored to the specifics of the of insurance industry.

Of primary importance in establishing our standing in relation to this Project and our concern for its substance, is explaining statutory accounting's reliance on and interdependence with GAAP. NAIC procedure involved in maintaining statutory accounting requires review of every FASB pronouncement and interpretation as potentially applicable for inclusion in statutory accounting. That review of FASB pronouncements by NAIC committees results in decisions to follow, modify, or dismiss such FASB pronouncements for inclusion in statutory guidance.

Although the relevant NAIC committees may themselves initiate statutory accounting authority or interpretations, it is nevertheless fully accurate to state that statutory accounting provides the great preponderance of statutory accounting's substance. By this process statutory accounting considers and subsumes much GAAP guidance. Indeed, GAAP is part of the formal hierarchy of authority underlying statutory accounting.

With that connection between GAAP and statutory accounting for insurance demonstrated, NAMIC asserts its standing as a respondent with deep and crucial interest in content of this project. Also relevant for our members' standing in conduct of this Project is the NAIC's current project for statutory accounting that will choose between the status quo or converge with GAAP or IFRS with certain exceptions or tailorings for the insurance industry.

The IASB's statement that it intended "significant improvements" to the accounting for insurance contracts by means of a "comprehensive measurement model" may be attractive intellectually and as a basis for an accounting standard that might impose order on information provided to users by a financial sector industry rich in diversity of its products. Yet when such an intent is brought to bear on the full diversity of products and practices in the insurance industry, its appeal weakens, and for some sectors of the industry, fails.

Such failure or impracticality of a single model for the entirety of a diverse industry occurs in the case of short duration contracts. We were somewhat relieved to see in the Discussion Paper the Board's preliminary openness to a "modified" approach, yet we have many and serious reservations with respect to the "modified" approach as described in the IASB Exposure Draft.

Short duration, property-casualty contracts heavily predominate among business written by the NAMIC membership. Those members feel strongly that the single model is impractical for that business and entails expense, effort, and complexity that would not render incremental utility or quality of information to users of statutory or GAAP financial statements. Even in the instance of extraordinarily high interest rates, it is still doubtful that the full or "modified" IASB model would yield additional transparency for short duration contracts.. Because of this doubt, our responses here suggest or assert that current accounting for short duration property-casualty insurance contracts should endure.

Responses to Questions:

1. The phrase "indemnify or compensate" might best capture the full species of exchange occurring as a result of the insurable event. The words are not necessarily interchangeable; therefore, inclusion of both best conveys what may be prescribed in all species of insurance contracts.
2. Building a definition around type of entity would add nothing—and perhaps complicate—financial reporting, despite the somewhat complex or porous boundaries between those contracts that are within and those outside the scope of the draft. Consistent with our comments below, it is conceivable that distinction between short duration and other contracts would have utility.

3. All in all, yes, because the crucial element, risk, is not intended. Certain derivatives used in financial engineering might be asserted as in scope, but the nature of the risk with which they are associated is usually financial.

4. No. Benefits, even if understood as part of compensation, do not generally have characteristics of an arm's length transaction and would in many cases not fit the definition of contract. Certain executive-benefit arrangements may more closely fit the proposed definition, but their particularity would seem to disqualify them from any convenient characterization or standardizable insurance model.

5. We agree with the Board's preliminary view that such participating contracts lie outside the scope of this model.

6. Although unbundling may conceivably be relevant for non-life contracts, its presence in that sphere of the insurance business is in fact *de minimis*. Therefore, we do not have useful comment in response to this question.

7. Use of a stochastic approach in estimating future cash flows is rational or practical only to the extent that a longer prospect in time is involved. Applying such estimation to cash flows occurring, for example, within less than one year involves analysis and expense that is superfluous. The normal estimates made by a property-casualty insurance entity wholly suffice to anticipate the magnitude of cash flows occurring within a year's prospect. Actuarial judgments additionally applied to the quantum of reserves and reinsurance give credibility to balance-sheet amounts. The same argument may apply to still longer periods when ambient interest rates are low. Applying stochastic analysis to one year's prospect of cash flows is gilding the lily and not tenable in terms of existing methods of running the property-casualty entity. For such short duration contracts, existing GAAP or statutory accounting provides users information that is fully adequate. It should be further understood that probability-weighted estimates have theoretical strength but in practice are subject to error.

8. We argue in this set of responses that neither the single model nor the "modified" model espoused by the IASB is useful for insurers' reporting on their books of short duration property-casualty contracts. Our answer here, therefore, should be understood in that semi-agnostic light: Such an adjustment is understandable and has ample precedent in both theoretical and applied finance. The question, we notice, is posed as whether the estimate of net cash flows should "include" a risk-adjustment margin. Perhaps it makes no difference, but our concept is, instead, that the risk adjustment would be "applied to" the estimate of net cash flows.

9. Our concern lies primarily with short duration property-casualty contracts, and we believe the the risk-adjustment margin is not practical in such context. With respect to contracts of longer duration the risk-adjustment margin complements the present value of the probability-weighted net cash flows. Recognition of an additional, incremental element of risk is rational for application to any longer prospect of time, assuming that the probability weighting applied to cash flows does not duplicate such risk. That the

risk-adjustment margin is defined solely as the maximum amount the insurer would pay to divest itself of this element of risk seems somewhat problematic. Actuarial techniques may be applied here, but this element injects a subjective dimension in not being testable against a market.

10. Stochastically, this premise is logical, assuming sufficiently large numbers of contracts. We note that the question is not posed on a *ceteris paribus* basis and uses the word “comparable.” There is reason, in other words, not to give strong affirmation of the premise.

11. We demur on application of the single model, full or “modified,” to short duration property-casualty contracts. For longer duration contracts, the “building blocks” approach and its description of cash flows are a reasonable, if not finished, design.

12. We do *not* agree that the carrying amount of *all* contracts should be discounted. It is wholly practical, and reasonably conservative in the great majority of scenarios, to avoid discounting on short duration property-casualty contracts. Although there may be stochastic behavior in books of short duration property-casualty business the brief prospect for their retirement makes discounting an unneeded exercise. Even for ambient conditions involving extraordinarily high interest rates—whether risk-free or some other rate—short contract duration obviates need for discounting and does no disservice to users of financial statements. It is only when users must make sense of long duration business that the intellectual utility of discounting becomes powerful. Current conventions in accounting for short duration contracts should be retained.

13. Consistent with our regard for treatment of short duration contracts, treatment of cash flows related to acquisition costs is not an issue for us.

14. Consistent with our regard for treatment of short duration contracts, distinction between full and incremental costs of acquisition is not an issue for us.

15. With respect to short duration contracts we do not favor application of either the full or “modified” method to short duration property casualty contracts, believing that it is impractical to do so and that users of financial statements are not disadvantaged by current accounting for such contracts. In surveying the attributes for longer duration contracts of the IASB’s two-margin method and this Board’s favor for a composite margin, we are left with a number of insecurities about the two-margin approach. For longer duration—and not short duration contracts—the composite margin appears a more rational and unified method.

16. For short duration property-casualty contracts, as related above, we do not favor use of a margin and instead believe that current accounting is more practical and provides adequate information for the user of financial statements. For longer duration contracts the ratio described in paragraph 83. is not objectionable.

17. We agree. Our concerns are for that accounting to be used for short duration property-casualty contracts, and we do not believe in the practicality of accretion of interest for such business.

18. No, we do not. Finally, the premise associated with the new method or methods under consideration in this Project is that users of financial statements would be better served in valuing insurance contracts via use of discounted, probability-weighted cash flows, margins, and accretion of interest. Yet no disservice, practical or theoretical, to users of financial statements is shown as a consequence of the use of current accounting conventions in reporting on short duration property-casualty contracts. In short, we emphatically assert that the single-model approach for recognition and measurement of insurance contracts is inappropriate and impractical for short duration property-casualty contracts.

19. The current method of accounting for short duration property-casualty contracts is fully adequate, and we propose this as the alternative. Use of probability-weighted, discounted cash flows with a margin or margins plus interest accretion is not needed for these contracts, which expire on an annual or more frequent basis and are subject to the volition of the policyholder for renewal. In the vast “retail” space of the property-casualty space, we are not aware, given the reference to paragraph 106., of material problems with “onerous” contracts.

20. Understanding that volatility will inevitably be added in some measure to reporting as a result of ambient interest rates and discounting, the “building-block” approach to valuing longer duration insurance contracts is theoretically sound. For short duration insurance contracts, however, such an approach entails excess analysis, detail, and cost. Even with application of the IASB’s “modified” approach to short duration contracts, it would appear that more accounting or actuarial complexity is prescribed than would result in commensurate or useful understanding of the reporting entity’s financial condition. Discounting and the accompanying accretion, as described in the “modified” approach are at the heart of this excess complexity and would seem, even in the instance of extraordinarily high interest rates—whatever they may be based on—to be beyond what is needed for successful understanding of financial statements.

21. Duration of coverage period best accomplishes a scope criterion.

22. Above, we assert that decision-useful information is not provided in the case of short duration property-casualty contracts. In the instance of embedded derivatives being part of short duration contracts, assessment of and possible recognition of any variance in cash flows occurring beyond the short duration period may be necessary.

23. Our concern is with reporting on short duration property-casualty contracts. We do not opine here on health contracts.

24. Our interests lie with short duration property-casualty contracts, and we believe that the currently sanctioned accounting for such contracts is wholly serviceable for both users of financial statements and preparers.

25. The incremental one-time costs of adopting the alternatives comprise or at least include: Software, integration of such software with existing systems, training at the general and applied level to all personnel who would deal with the changes prescribed, actuarial consultation, and extensive testing of results and integration with the balance sheet. Incremental ongoing costs would comprise or at least include: Actuarial consultation, software updates, training. Our membership includes a complete spectrum of sizes of property-casualty insurers, and describing costs we must emphasize that such incremental costs as described here are typically disproportionate for smaller insurers.

26. We do not believe we fully understand what is proposed here. An integrated picture seems not to be presented.

27. Symmetry between recognition and measurement of reinsurance contracts is desirable, however it should be noted that, with the exception of facultative certificates, rarely does a reinsurance contract pertain to a single underlying contract as is implied in the question. The language in the Exposure Draft regularly refers to the underlying “contract” ceded, implying that there is one underlying policy for each reinsurance contract. In fact, this is rarely the case. Reinsurance contracts normally encompass a portfolio of policies.

28. Perhaps we are rooted in existing practice and detail, but our understanding of the reporting entity’s insurance liability is as good or better with the current reporting approach than with the margin presentation.

29. We understand the choice as taken within the context of the proposed new accounting for insurance contracts, which we do not favor for short duration property-casualty contracts. If change must occur, the premium-presentation approach would seem much more useful for insurers in our lines of business.

30. We suggest that there is no cogent reason, given differences in the nature and purpose of the associated coverages, that short- and long-duration contracts be presented in a similar manner.

31. We do not agree with the IASB Exposure Draft’s proposal for insurance contracts as it may apply to short duration property-casualty contracts. The proposed disclosures may be consistent in the proposal’s context, yet it is not practical for short duration property-casualty contracts.

32. With respect to the choices a. through e., we find no good it for our belief that current accounting for short duration property-casualty contracts is wholly adequate. Perhaps option d., to the extent it accomplishes that end, could be forwarded as an answer, but simply find it impractical and expensive to impose either the full or

“modified” IASB approaches to short duration property-casualty contracts. If there would be reason to prognosticate that extraordinarily high interest rates would prevail for years, then perhaps application of an approach more congruent with the IASB’s would be appropriate. Yet that is not, we believe, a reasonable projection. Long duration contracts may require, as do many long term credit instruments, analysis that is consistent with that embodied in the IASB’s approach, which may reach far into the future to assess probabilistic cash flows adjusted for the time value of money. Such analytical process, imposed when contracts of a year or less in duration renew constantly, is beyond what is practical or decision-useful for the user of financial statements.

Respectfully submitted,

A handwritten signature in cursive script that reads "William D. Boyd". The signature is written in black ink and is positioned above the printed name.

William D. Boyd, CPA
Financial Regulation Manager