

Michael Monahan

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November 30, 2010

Ms. Leslie F. Seidman, Chairman Financial Accounting Standards Board 401 Merrit 7 Norwalk, CT 06856-5116

Re: Preliminary Views on Insurance Contracts (DP)

Dear Ms. Leslie Seidman:

The American Council of Life Insurers (ACLI)¹ welcomes the opportunity to provide comments on the FASB Discussion Paper: *Preliminary View on Insurance Contracts* (DP). We observed that the FASB and IASB views differ on important aspects of the proposed guidance, which are described in the Appendix to the DP. These differences need to be resolved before issuing a final standard to minimize/avoid reopening the standard for subsequent changes to achieve convergence. Due process should not be constrained by an arbitrary June 2011 target date tentatively set by the IASB. Instead, ample time should be spent addressing: (i) the differences in views between the two Boards; (ii) industry concerns with the proposed guidance, and (iii) results gathered from conducting sufficient field testing to ensure the guidance is operational and cost effective.

The ACLI supports a comprehensive high quality standard for insurance accounting that provides a level playing field with other financial institutions. Within such a standard we support the building block approach that allows the use of *entity specific* assumptions rather than market inputs where such inputs are unavailable. We believe that the presentation approach needs to provide useful and understandable information to the users of the financial statements that represents the nature of the business. Also, we support an accounting standard that becomes operational within a realistic timetable without undue implementation and maintenance costs.

As currently drafted, the measurement model is not sufficiently developed to provide relevant information that will help users make economic decisions. The DP is a good start, but it needs refinement as noted in the comments that follow. In addition, we have significant reservations about the presentation model. The margin presentation approach is a major change from the current presentation approach and we believe it may misrepresent the nature of the insurance business by moving key information used today to the financial statement footnotes. In a future letter we will offer an alternative presentation retaining premiums, benefits and expense information in the financial statements reorganized to focus on sources of earnings.

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¹ The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S life insurance and annuity industry.

Critical Issues

In our review of the IASB Exposure Draft, *Insurance Contracts*, (ED) and the DP, we have identified a set of critical issues that concern our members:

- Timing and implementation
- Discount rate prescribed as the risk-free rate adjusted for illiquidity
- Explicit margins: risk/residual margin vs. composite margin
- Unbundling components of insurance contracts
- Cost option alternative to "current fulfillment" measurement
- Acquisition costs included in measurement
- Reinsurance
- Presentation
- Disclosures
- Transition

In the process of developing our comments on the specific questions, we have attempted to provide detailed responses and recommendations. A summary of our recommendations as they relate to the critical issues is as follows:

Timing and implementation

We are especially concerned about the timing and implementation of the insurance accounting standard. We believe the proposed IASB timetable with a target completion date of June 30, 2011 is overly aggressive since the FASB is not at the same point in the development of an insurance standard. We have expressed in the past and continue to express support for the convergence and development of high-quality accounting standards. However, without resolution of the IASB and FASB differences on insurance and consideration of the concerns expressed in this and other industry letters, the risk is the outcome will not produce a quality product, will not reflect the nature of the business, and will not produce a level playing field with other financial institutions. In addition, we believe that the Board should undertake sufficient field testing to ensure that the final guidance is operational within a reasonable cost. Finally, ample time to implement the new standard is critical. Member companies who have already moved to or are in the process of moving to standards similar to the one proposed have indicated that the work effort and the associated costs are significant. At a minimum we recommend that an implementation time frame be 3-5 years.

Discount rate prescribed as the risk-free rate adjusted for illiquidity

The overarching principle for the discount rate should be consistency with the insurer's business strategy, taking into account the way the business is priced and managed. Therefore, no single method should be prescribed. Rather, a range of methods should be described as ways to satisfy the principle of considering the time value of money within the accounting model with sufficient disclosures as a supplement. Our letter dated November 22, 2010, provides our recommendations and rationale for our views on this topic.

Explicit margins: risk/residual margin vs. composite margin

The majority view of the ACLI members is that the composite margin approach better reflects the nature of the business and that the measurement of any asset and liability should be based on the terms of the contract with policyholders. A minority view expressed by some ACLI members supports the risk residual margin. Regardless of the method, we are concerned about the proposed run-off methods that tend to back-end profits. Details of both views were contained in our October 26, 2010 letter about margins.

Unbundling

At this time, we cannot definitively answer the question whether it is appropriate to unbundle some components of an insurance or reinsurance contract. Our answer will depend upon the resolution of other measurement issues such as scope, boundaries of the contract and whether a cost option is added as a measurement alternative. However, we believe that the guiding principle for insurance contracts should be that the components of the contract should not be unbundled because of the interdependence of the components and unbundling should not result in arbitrary allocations. Unbundling, in limited cases, may be appropriate for certain long-duration contracts where unbundling is consistent with the way the portfolio is managed and unbundling the components provides useful information to the users.

Cost option alternative to "current fulfillment" measurement

While we have no objection to the current fulfillment measurement approach, we are concerned that the insurance accounting standard will not align with the guidance in IFRS 9, *Financial Instruments*, where financial instruments may be measured at fair value or amortized cost. Limiting the measurement of insurance contracts to a current value measurement could put insurers at a disadvantage with other financial institutions for financial products. The ACLI recommends that the Board add a cost option alternative within the insurance contracts standard. We plan to submit a detailed proposal addressing the various issues that the Board will need to consider in order to include a cost option within the insurance standard.

Acquisition costs included in measurement

We support a definition of acquisition costs to be included in the measurement of the insurance contract liabilities based upon the recently issued FASB guidance in ASU 2010-26. The FASB guidance more appropriately reflects the economics of the insurance business in part by considering acquisition costs on a portfolio basis.

Reinsurance

Our observation is that the proposed reinsurance guidance is insufficient to address the diversity of reinsurance contracts and their complexity. While the reinsurance principle is a good starting point, more guidance is needed. We recommend that the Board carefully consider the appropriate guidance for credit risk, risk transfer, and reinsurance disclosures. We will follow up with a separate letter on these and other reinsurance issues.

Presentation

We do not support the proposed margin presentation approach. The insurance business fundamentally involves the collection of premiums and the payment of claims and associated expenses. While we agree that the presentation should flow from the measurement of insurance contracts, we believe that the cash flow components of the building blocks, premiums, benefits, and expenses, are as essential to the measurement as the margin component and therefore merit equally prominent presentation on the face of the financial statements. In addition, we believe that the recognition of premiums as deposits, with expenses, claims and benefit payments as withdrawals would be a fundamental change to current practice, which may misrepresent the nature of the business and result in a loss of essential information for users of financial statements. We will provide a separate letter detailing our recommended alternative.

Disclosures

While we agree with the disclosure principle, we believe the proposed guidance is overly prescriptive and burdensome. Since we believe that considerable work remains to address various aspects of the insurance standard, it is difficult to recommend specific changes at this time. Our

recommendation is that the Board re-visit the disclosure requirements once the measurement, reporting and transition guidance is known.

Transition

We are keenly aware of the challenges transitional guidance will pose. The measurement of the insurance contract liabilities at transition will be influenced by many market factors that cannot be predicted. Consequently, we disagree that the residual margin should be set to zero with any difference reported as an adjustment to retained earnings on the adoption date of the new insurance contracts standard. Such an outcome will not only misrepresent the nature of the business, but will also result in lower earnings in subsequent periods on the in-force business that will have a lasting effect especially for long-duration contracts.

Conclusion

The ACLI continues to support a high-quality, principle-based, global accounting standard for the measurement and reporting of insurance contracts that is a faithful representation of the business providing relevant and understandable information to users of the financial statements. However, we believe that considerable work remains to address specific measurement, presentation, disclosure and transition issues. We also believe it is essential that sufficient field testing be conducted to ensure the guidance is operational at a reasonable cost with the resulting financial statements and disclosures reflecting the nature of the insurance business and providing useful information to the user community. We appreciate the opportunity to provide comments and look forward to continuing to work with you on this initiative.

Sincerely,

Michael Monahan

Director, Accounting Policy

FASB-Discussion Paper: Preliminary Views on Insurance Contracts

QUESTIONS FOR RESPONDENTS

For ease of use, all of the questions for respondents in this Discussion Paper are presented here. Each question also is repeated in the section to which it relates.

Definition and Scope

1. Are the proposed definitions of *insurance contract* and *insurance risk* (including the related guidance) understandable and operational?

ACLI response

We agree that the proposed definitions of *insurance contract and insurance risk* are understandable and operational. As noted in paragraph 21, Topic 944 does not explicitly define an insurance contract and we believe the proposed definitions would be an improvement.

2. If the scope of the proposed guidance on insurance contracts is based on the definition of an insurance contract rather than on the type of entity issuing the contract, would financial reporting be improved?

ACLI response

Yes, we believe that financial reporting would be improved by developing an accounting standard for insurance contracts rather than for insurance entities. Greater consistency and comparability is achieved by focusing the guidance on insurance contracts since reporting entities other than insurers may engage in activity that meets the definition of insurance.

3. Do you agree with the proposed scope exclusions? Why or why not?

ACLI response

We generally agree that self-insured contracts should be scoped out of the insurance contracts. However, we have the following concerns:

- i) In some cases employee benefit plans, typically the defined benefit plans, subscribe to insurance contracts issued by insurance entities. Most often such contracts are annuities with investment in separate accounts. A strict application of the guidance under this paragraph may result in these types of contracts being scoped out.
- ii) We further request clarification on the application of this guidance to insurance contracts between affiliated entities. As an example, a corporate owned life insurance (COLI) contract that is issued between subsidiaries may result in the contracts being scoped out of this ED at the subsidiary level as well.
- 4. Should benefits that an employer provides to its employees that otherwise meet the definition of an insurance contract be within the scope of the proposed guidance? Why or why not?

ACLI response

See our response to Question #3.

5. The Board's preliminary view is that participating investment contracts should not be accounted for within the proposed model for insurance contracts but, rather, should be

included in the scope of the proposed model for accounting for financial instruments. Do you agree? Why or why not?

ACLI response

We believe that financial instruments with a discretionary participation feature (DPF) should be within the scope of the standard on insurance contracts and hence accounted for on a consistent basis to insurance contracts. We believe that the insurance contracts standard should apply to all such contracts—not just those that share in a pool with insurance contracts—because the insurance contracts standard is the only IFRS standard in existence or under development that explicitly addresses discretionary participation features.

6. Do you support the approach for determining when noninsurance components of contracts should be unbundled? Why or why not?

ACLI response

At this time we cannot definitively answer the question whether it is appropriate to unbundle some components of an insurance or reinsurance contract. Our answer will depend upon the resolution of other measurement issues such as scope, boundaries of the contract and whether a cost option is added as a measurement alternative. Our view is that any decision about unbundling, if necessary, should focus on decision-useful information taking into account the way the business is managed. While unbundling may be appropriate for some contracts, generally, for most types of life insurance and other long-duration contracts, such as disability and long-term care contracts, unbundling of components would misrepresent the nature of the business and add undue complexity. The various components are designed, priced, and managed on an integrated basis. The cash flows from all of the components affect the settlement of the contract, and the policyholder generally cannot surrender one component of the contract without surrendering the entire contract. Consequently, unbundling could result in an arbitrary separation of the contract's components.

Recognition and Measurement

7. Do you agree with the use of the probability-weighted estimate of net cash flows to measure insurance contracts? Does that approach faithfully represent the economics of insurance contracts? Is it an improvement over existing U.S. GAAP?

ACLI response

We agree conceptually with the use of probability-weighted cash flows as provided for in the building blocks and that the proposed language would be an improvement to U.S. GAAP. However, we believe the standard should clarify that this does not always require a full stochastic approach. We believe for certain types of insurance policies or under certain circumstances it may be acceptable to use a single or limited number of possible scenarios.

In our May 13, 2010 letter to the IASB on the Exposure Draft-Measurement of Liabilities in IAS 37, we recommended that the "most likely outcome" language described in paragraph 40 of IAS 37 should be retained. Similar guidance should be included for insurance contracts where there is a high probability about the expected outcome. For example, if there is a 98% probability of paying \$2,000 to settle a contested claim, a 1% probability the amount could be \$50,000 and 1% that the amount could be \$100,000, the probability-weighted amount of \$3,460, in our opinion, does not provide the users with any better information than reporting \$2,000 – the most likely outcome. In fact, some may argue that reporting \$3,460 would be misleading.

8. Do you think that an entity's estimate of the net cash flows should include a risk adjustment margin?

ACLI response

See ACLI letter dated October 26, 2010 addressing this question.

9. Is the objective of the risk adjustment margin understandable? If so, do you think that the techniques for estimating the risk adjustment margin (see paragraph 52(b)), faithfully represent the maximum amount that the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected?

ACLI response

See ACLI letter dated October 26, 2010 addressing this question.

10. Do you think that the risk adjustment margin would be comparable for entities that are exposed to similar risks?

ACLI response

See ACLI letter dated October 26, 2010 addressing this question.

11. Do you agree with the description of cash flows that should be included in the measurement of an insurance contract? Is the proposed guidance operational?

ACLI response

We are in general agreement with the description of cash flows to be included in the measurement of an insurance contract except for the definition of acquisition costs, which we believe should be revised. Please see our response to question #13 for our recommended changes to the acquisition component. We believe the proposed guidance is operational with the inclusion of our recommended changes to the acquisition component.

12. Do you agree that the carrying amount of all insurance contracts should be discounted if the effect is material? Do you agree with the proposed guidance on the discount rate that should be used to measure the carrying amount of insurance contracts? If not, which discount rate should be used?

ACLI response

See ACLI letter dated November 22, 2010 addressing this question.

13. Do you think that acquisition costs should be included as one of the cash flows relating to the contract? If not, how would you account for acquisition costs?

ACLI response

Yes, we agree that incremental acquisition costs should be included in the initial measurement of the insurance contract. However, we believe that the definition of acquisition costs should align with the FASB's definition of acquisition costs as recently codified in ASU 2010-26. Such alignment would result in an expansion of the definition of acquisition costs to include costs such as underwriting, medical examinations, and policy issuance and certain direct response advertising costs. This would be more reflective of the nature of how insurance business is acquired and encompasses more critical components of acquiring new and renewal business than the IASB proposed definition. In addition, we believe that acquisition costs should be considered

on a portfolio basis rather than an individual contract basis in order to harmonize with other aspects of the measurement model.

Paragraph B61(f) of the IASB Exposure Draft states that relevant cash flows to be included in the liability measurement include, "the incremental costs of selling, underwriting and initiating an insurance contract for those contracts that have been issued". We believe that this language leads to confusion because it appears that the IASB is in agreement with the FASB's conclusion in ASU 2010-26 that other direct costs such as underwriting, policy issuance, etc. are deferrable for successful contracts. In Paragraph BC140, however, the IASB reveals that the decision to limit acquisition costs to only incremental costs was made in part to be consistent with IAS 39 and IFRS 9 with respect to the treatment of transaction costs of financial instruments. IAS 39 defines transaction costs to include fees and commissions paid to agents, but excludes internal administrative or holding costs. Paragraph B61(f) states that incremental costs are costs that the "...insurer has incurred because it has issued that particular contract...", which we believe may lead to the interpretation that these costs could exclude functions such as underwriting and medical/inspection fees because these costs are incurred regardless of whether a contract was placed. We feel that this definition is too narrow and may exclude items that the IASB intended to include in the definition of incremental costs.

Below is a high-level summary of the amount of acquisition related costs that are permitted to be deferred in ASU 2010-26 and the amount of acquisition costs included in the liability measurement under the ED with what we believe to be the definitional discrepancies noted in bold:

	ASU 2010-26	IASB ED
Incremental Direct Costs		
Commissions paid to employee agents	Deferred	Included
		in Measurement
Premium taxes for certain products	Deferred	Included
		in Measurement
Amounts paid to 3 rd parties	Deferred	Included
		in Measurement
Other direct costs for successful efforts		
Underwriting	Deferred for successful	Expense as Incurred
Policy issuance and processing	Deferred for successful	Expense as Incurred
Medical and inspection	Deferred for successful	Expense as Incurred

ASU 2010-26 also addresses the treatment of direct-response advertising costs and specifies that advertising costs should only be included if the direct-response advertising criteria in Subtopic 340-20 are met. The ED does not address the treatment of advertising costs in the definition of incremental acquisition costs to be included in the measurement of the liability. Therefore, the ACLI recommends that the ED should adopt the language within ASU 2010-26 related to direct-response advertising.

In addition to the differences between the ED and ASU 2010-26 relating to the definition of incremental acquisition costs, the ED proposes that the unit of account for determining acquisition costs be at the individual insurance contract level while ASU 2010-26 favors a portfolio approach. In paragraph B61(f) of the ED, the IASB states that "these costs are identified at the level of an individual insurance contract rather than at the level of a portfolio of insurance contracts." We believe that a portfolio approach to the determination of incremental

acquisition costs to be included in the measurement is more appropriate and can be reasonably determined based on standard costing and other methods aimed at quantifying acquisition costs for a group of policies. ASU 2010-06, paragraph 944-30-55-1D, states that standard cost methods such as actual costs, job process costs, and job order costs may all be used in combination to identify acquisition costs for successful contracts across a portfolio of contracts. Additionally, the estimates are to be reviewed and analyzed periodically and updated as necessary. As a result, a portfolio approach for the determination of incremental acquisition costs in the measurement of the liability should be clearly stated to be consistent with all other aspects of the insurance liability measurement.

Finally, we recommend that the Boards reconsider the presentation requirement in paragraph 72(c) of the Exposure Draft requiring that acquisition costs not incremental at the individual contract level (i.e., those costs that are expensed as incurred) be reported separately within the insurer's statement of comprehensive income. We believe that separately reporting these costs does not provide useful information to the users and may only serve to add cost to the process. The objective of ASU 2010-26 was to address diversity in practice regarding the interpretation of which costs relating to acquisition or renewal of contracts qualify as deferrable. Therefore, we recommend that the non-incremental acquisition costs should not be disclosed as a separate line item on the face of the Statement of Comprehensive Income.

14. Do you agree that acquisition costs included in the cash flows used in the measurement of the insurance contract should be limited to those that are incremental at the individual contract level? If not, which acquisition costs, if any, would you include in the measurement of the insurance contract?

ACLI response

See our response to Question #13.

15. Do you agree with the use of either the composite margin approach or two-margin approach to measure the net insurance contract? Does either approach faithfully represent the economics of insurance contracts? Is either approach an improvement over the measurement used in current U.S. GAAP?

ACLI response

See ACLI letter dated October 26, 2010 addressing this question.

16. Do you think that the composite margin should be recognized in earnings in subsequent periods using the ratio described in paragraph 83? If not, how would you recognize the composite margin in earnings?

ACLI response

See ACLI letter dated October 26, 2010 addressing this question.

17. Do you agree that interest should not be accreted on the composite margin? Why or why not?

ACLI response

See ACLI letter dated October 26, 2010 addressing this question.

18. Do you think that all insurance contracts should be recognized and measured using one approach or that some insurance contracts should be recognized and measured using an alternative approach (for example, the modified approach)? Why or why not?

ACLI response

We support a mixed attribute model, i.e., current fulfillment or cost option. The proposed measurement attribute for insurance contracts is a single method: current fulfillment with unlocking of assumptions each reporting period. While we have no objection to this measurement, we are concerned that the insurance accounting standard will not align with the *Financial Instruments* guidance where financial instruments may be measured at fair value or amortized cost. Limiting the measurement of insurance contracts to a current value measurement could put insurers at a disadvantage with other financial institutions for certain products. We recommend that the Board add a cost option alternative within the insurance contracts standard. Because a cost option for insurance needs to be properly vetted, we plan to submit a detailed proposal addressing the various issues that the Board will need to consider such as the lock-in methodology, criteria for unlocking, limitations about its use, and disclosures.

We recommend that the Board consider retaining current U.S. GAAP guidance for short-duration contracts, typically referred to as the unearned premium reserve (UPR). We noted key differences between the Premium allocation approach (PAA) proposed by the IASB and the UPR including the PAA's requirement to discount premiums expected to be received in approximately twelve months or less; a more complex balance sheet presentation; the inclusion of an interest component; the requirement to net incremental acquisition costs against the pre-claim obligation, and a requirement to continuously compute the fulfillment cash flows at a more granular level than that required under today's premium deficiency test.

19. If an alternate approach is required for some insurance contracts, what recognition, measurement, and presentation provisions should be applied (including those items noted in paragraph 106)?

ACLI response

See our response to Question #18.

20. Do both the building-block approach and the modified approach (with the latter approach applied only to certain short-duration contracts) produce relevant and decision-useful information? Why or why not?

ACLI response

Yes, we believe that both approaches produce relevant and decision-useful information since each, in its own way, reflects the way the business is managed, which should be the foundation of the accounting standard.

21. How should the scope of insurance products for each approach be defined (for example, duration of coverage period, duration of claims payment period, or type of insurance)?

ACLI response

We think the "time-based" rule of coverage periods of one year or less should be replaced. An alternative method of delineation is one based on the nature and purpose of the insurance contract. We would propose that the modified measurement approach, for example, apply to contracts that protect policyholders from losses arising from theft, damage to or destruction of insured property by a defined event, personal injury, or automobile damage sustained by the

insured and liability to third parties for losses caused by the insured. This would include most property-casualty insurance contracts.

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22. Are there specific types of insurance contracts for which the approaches would not provide decision-useful information?

ACLI response

We believe that any prescribed guidance that attempts to classify the products into a specific approach will be problematic as noted in our response to Question #21.

23. What are the implications of the recent U.S. healthcare reform to the application of the proposed contract boundary principle, including whether health insurance contracts written under the new reforms would meet the conditions in the proposed guidance to be accounted for under the modified approach?

ACLI response

The primary impacts of Health Care Reform on the accounting and reporting of insurance contracts is outlined in the Patient Protection and Affordable Care Act Medical Loss Ratio Regulation (PPACA). This regulation defines certain financial reporting terms such as earned premium, reserves, expenses, and paid and incurred claims. The scope and applicability of this regulation is defined by Section 2718 (b) of the Public Health Serves Act. Certain health products, with certain benefits are excluded (i.e. short-term limited duration insurance).

IASB's Exposure Draft defines contract boundaries as, "the point at which an insurer either 1) is no longer required to provide coverage or 2) has the right or the practical ability to reassess the risk of the policyholder and, as a result, can set a price that fully reflects that risk." Due to minimum loss ratio requirements imposed under the new regulation, the rights of the insurer to establish a price that fully reflects risk is limited or capped. In addition to separate definitions of contract boundaries, the regulation also defines what can be considered premium, expenses and resulting profits or margins and an approach to measurement of these attributes. These definitions conflict with the margin and measurement approach concepts as outlined in the exposure draft.

Due to the considerable differences between the PPACA Regulation and IASB's Exposure Draft, we recommend that those products and health benefits within the scope of the PPACA Regulation be excluded from the scope of the IASB's Insurance Contracts Paper.

24. What other changes should be considered to both improve and simplify U.S. GAAP for short- and long-duration insurance contracts?

ACLI response

We believe that the development of a comprehensive accounting standard for insurance contracts, one that is converged with the IASB, will greatly improve U.S. GAAP. A converged standard based upon a business model will enhance consistency and improve the usefulness of information for users of the financial statements.

25. What are the incremental costs of adopting the alternatives described in this Discussion Paper? Please separately describe one-time costs and ongoing costs.

ACLI response

The costs of developing a measurement approach based on the building blocks would be significant, as detailed below. The costs of developing a measurement approach similar to the IASB's modified approach may be somewhat less significant, but to the extent that elements of the building blocks approach are employed (for example in a liability adequacy test), the costs would likely be material.

Incremental costs that are primarily one-time costs would include the following:

- New modeling approaches. For example, it may be desirable to develop proxy formulas so as to avoid the necessity of projecting actual assets in modeling cash flows that depend on assets. This is not something that is typically done under current U.S. GAAP.
- New projection software and grid capabilities. New projection software may be needed to accommodate the need for stochastic projections and to determine a risk margin (under the IASB's approach). Additional grid capabilities may be needed to shorten runtime to the extent needed to allow reporting deadlines to be met.
- Training and human resources.
- Consulting and auditing fees.

Incremental one-time AND ongoing costs would include the following:

- The use of probability-weighted cash flows. This is most often contemplated in the context of economic risks, but it applies to other risks as well. Implementation requires probability distributions for multiple inputs as well as significant systems and enhancements.
- Determination of the illiquidity premium. The illiquidity premium is frequently a function of the predictability of policyholder cash flows. As a result, a periodic assessment of the predictability of portfolios of insurance cash flows would need to be developed, something that is not done currently.
- Runoff of residual/composite margins. From a mechanical standpoint, this process would
 probably be similar to DAC cohorts, making it similar to current processes. However,
 additional complications may result from the use of current discount rates if accretion of
 interest on the residual/composite margin is required.
- Determining a confidence interval equivalent for the risk margin. This is not something that is done currently and no simple translation exists. As a result, approximate methods would need to be developed.
- Unbundling. To the extent that unbundling is employed, the complexity of the reporting is multiplied.
- Separate presentation of reinsurance: Although this is currently the standard under U.S. GAAP, it creates an added dimension of complexity.
- Disclosures and sensitivities.
- SOX compliance.

Reinsurance

26. The scope of the proposed guidance includes reinsurance contracts that an insurer issues or acquires. However, insurance contracts held directly by other policyholders would be excluded from the scope of the proposed guidance. Do you agree with this exclusion? Why or why not?

ACLI response

We have no objection to excluding insurance contracts held by policyholders from the project scope so long as it is clear that the exclusion does not apply to reinsurance contracts.

27. Should there be symmetry between the recognition and measurement of reinsurance contracts and the underlying contract ceded?

ACLI response

No, the ACLI does not agree that there should be symmetry in recognition and measurement of reinsurance contracts and the underlying contract. Accounting for reinsurance contracts should follow the same principles used by the direct writer but should not imply that the parties will arrive at the same answer. For example, the portfolio of reinsurance contracts will not be the same portfolio as the direct writer nor will entity-specific assumptions be the same. To presume symmetry fails to recognize the nature of the business. For example, any non-proportional contract (such as stop loss covers) will inherently have very different economics from the underlying business. Second, for proportional contracts, there is often a different view and/or expectation on performance between the reinsurer and the direct company. Forcing either party to accept the other's views will create a lack of homogeneity in that company's financial statements that will tend to cause confusion and misunderstanding. The only conclusion is that each entity should measure the reinsurance contracts based upon its block of business, which will inherently be different from company to company. To facilitate discussion about the reinsurance issues outlined above and any other related reinsurance issues, we plan to submit a separate letter on the accounting for reinsurance contracts.

Presentation and Disclosure

28. The margin presentation approach highlights the changes in the insurance liability, rather than the current approach in U.S. GAAP, which presents, among other items, premium revenues, benefits paid, operating costs, and changes in loss estimates. Would this change improve your understanding of the performance of an entity that provides insurance (for some types of insurance or for all)? Please explain.

ACLI response

No, we do not believe that the proposed margin presentation approach would provide adequate useful information to users of financial statements. The insurance business fundamentally involves the collection of premiums and the payment of claims and associated expenses. While we agree that the presentation should flow from the measurement of insurance contracts, we note that the cash flow components of the building blocks are as essential to the measurement as the margin component and therefore merit equally prominent presentation on the face of the financial statements rather than being relegated to disclosure in the financial statement footnotes. In addition, we believe that the recognition of premiums as deposits and claims, benefit payments and expenses as withdrawals would be a fundamental change to current practice and may misrepresent the nature of the business and result in a loss of essential information for users of financial statements. Further, we believe that such a significant change from the current presentation would require a substantial effort to educate users of financial statements only to direct them to the disclosures or supplementary information such as the MD&A (Management Discussion and Analysis) or other non-GAAP measures

Because presentation is an important part of the measurement and reporting of information about insurance contracts, we will supplement this response with a separate letter addressing presentation issues. Our letter will include detailed examples of various approaches to assist the Board in their re-deliberations on this topic.

29. Should insurance contracts measured under the building-block approach be presented using a margin presentation approach or a premium presentation approach that would

require a true-up amount as described in paragraph 119 (for example, the written allocation presentation approach or the allocated premium presentation approach)?

ACLI response

See our response to Question #28.

30. Should short- and long-duration (or nonlife and life) contracts be presented in a similar manner even if such contracts are measured under different approaches?

ACLI response

See our response to Question # 28.

31. Do you agree with the proposed disclosures in the IASB's Exposure Draft? Why or why not? If not, what would you recommend and why?

ACLI response

No we do not think the proposed disclosure requirements will meet the proposed objective. We are concerned about the significantly high volume of disclosure requirements. Compliance will be costly and likely provide only limited benefit to users. For example, the disclosures requiring reconciliation of all components of the insurance liability will not be helpful to users of financial statements in understanding the variability in amount, timing, and uncertainty of actual cash flows, which we believe to be more relevant. The release of the residual margin or composite margin is nothing more than a systematic run-off over a period of time. We are also concerned about disclosing proprietary information. For example, the disclosures include qualitative information about risk exposures and risk management techniques and methodologies based on information provided internally to key management personnel. These requirements may be crossing the line between useful information and confidential information.

It is difficult to comment on all aspects of the proposed disclosure requirement at this time when it is unclear what will be the final guidance with respect to measurement and presentation. We recommend that the entire disclosure section be revisited and modified as needed based upon the final standard. We plan to re-examine the disclosure requirements during the re-deliberation process and we will provide additional comments.

Additional Question for Respondents

- 32. After considering your views on the specific issues contained in this Discussion Paper and the IASB's Exposure Draft, what do you think would represent the most appropriate improvement to U.S. GAAP?
- a. Pursue an approach based on the IASB's Exposure Draft?
- b. Pursue an approach based on the IASB's Exposure Draft with some changes? Please explain those changes.
- c. Pursue an approach based on the Board's preliminary views in this Discussion Paper?
- d. Pursue an approach based on the Board's preliminary views in this Discussion Paper with some changes? Please explain those changes.
- e. Make targeted changes to address specific concerns about current U.S. GAAP (for example, items included in paragraph 7)? Please describe those changes.

ACLI response

We believe the answer is a combination of "d" and "e". Current U.S. GAAP should not be replaced in its entirety. For example, current guidance for short-duration contracts may not need substantive changes. While we agree with many of the Board's preliminary views, changes are

needed as described in this response. We also observed that the FASB and IASB views are very similar and we encourage the two Boards to continue their work toward developing a single high quality accounting standard for insurance contracts.