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Technical Director—File Reference No. 1870-100  
FASB  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

Sent via email to [director@fasb.org](mailto:director@fasb.org)

**Discussion Paper – *Preliminary Views on Insurance Contracts***

The Allstate Corporation (“Allstate”) is pleased to provide comments on the Financial Accounting Standards Board’s (“FASB”) Discussion Paper – *Preliminary Views on Insurance Contracts* (“DP”) which also elicits comments on the International Accounting Standards Board’s (“IASB”) Exposure Draft – *Insurance Contracts* (“ED”). Allstate fully supports the FASB’s efforts, together with the IASB, to develop a single set of high quality global accounting standards that includes a comprehensive insurance standard. Allstate has been actively engaged in the insurance contracts project for a number of years as we recognize the importance of the project and its potential impact not only on our company, but the global insurance industry. Moreover, we understand the limitations in IFRS 4 *Insurance Contracts*, and appreciate that many jurisdictions do not have a comprehensive insurance accounting standard, however, the quality and fitness for purpose of the final global standard is of paramount importance.

Absent the need for a comprehensive accounting standard for jurisdictions reporting or preparing to report under International Financial Reporting Standards (“IFRS”) and the existence of the IASB’s Phase II Business Project, Allstate would not have advocated changes to the existing measurement and reporting model for non-life insurance contracts under United States Generally Accepted Accounting Principles (“U.S. GAAP”), which we continue to support. However, we understand and support the desire for a global insurance accounting standard and have developed responses based on what we believe is a proposal that would satisfy the global desire to utilize a measurement and reporting methodology that best matches a reporting entity’s insurance business model and the desire to develop a standard that is consistent with the recently released Conceptual Framework.

Given the importance of the global insurance industry, we urge the Board to carefully consider the impacts of the DP and the ED through extensive field testing and evaluation of the results in the most transparent manner possible.

Allstate is the largest publicly held personal lines insurer in the United States and while we also have a significant life insurance operation, our comments are primarily focused on the potential impacts of the DP and the ED on our property-casualty business.

Allstate has closely followed the IASB’s Phase II Insurance Contracts Project both before and after it became a joint FASB-IASB Project. During this time we have provided a significant amount of feedback to the Boards both separately and through insurance trade groups. We

have urged the Boards to develop a standard that is consistent with the “business of insurance.” At the same time, we have noted that the property-casualty and the life insurance businesses are fundamentally different and warrant either separate measurement and disclosure models or different applications within a single integrated model.

We believe the Boards made a critically important decision in the development of their respective financial instruments standards in adopting a business model approach. The importance of a business model approach is that it requires reporting entities to classify and measure financial instruments in a manner consistent with how they are used in the context of their adopted business model. We believe it is critical that the Boards extend the business model approach to the measurement and reporting of insurance contracts, including non-life insurance contracts. More specifically, developing a business model approach, as more fully described herein, would allow non-life insurers to measure and report their insurance contracts in a manner consistent with their business model (i.e., with how they underwrite, manage, and evaluate performance).

The fundamental importance of a non-life business model approach is its consistency with both the manner in which the underlying non-life insurance business is conducted and the Boards’ recently adopted Conceptual Framework which focuses on the fundamental attributes of relevance and representational faithfulness and enhancing attributes which include comparability and understandability.

The business model approach we recommend would allow the Boards to maintain the majority of the existing ED proposal, with certain proposed modifications. Our proposal would replace and expand the proposed Premium Allocation Approach (“PAA”) with application guidance that is more consistent with the relevant, representationally faithful, understandable and comparable measurement and reporting framework currently in existence throughout most of the world.

The basic modifications we propose are as follows:

- Replace the PAA in the ED with the existing Unearned Premium Reserve (“UPR”) currently in use throughout most of the world.
  - The discounting of ultimate premiums to be received over periods of approximately one year or less adds substantial operational complexity to the measurement model without compensatory benefit.
- Replace the proposed recognition criteria (earlier of contract inception or binding date) with contract inception.
  - The proposed recognition criteria adds substantial operational and reporting complexity without compensatory benefits.
- Introduce an alternative measurement and reporting application into the ED (i.e., alternative to the fulfillment cash flows) for the post-claim period that is consistent with the non-life insurance business model currently in place throughout most of the world. The alternative measurement and reporting application includes the following (modifications to existing U.S. GAAP are italicized):

***Application A – Classic Business Model***

- Acquisition costs, determined on an incremental basis, would be presented separately and not netted from UPR (or the PAA) as required under the ED as UPR is a key financial metric for non-life insurers. The amortization of acquisition costs would be similar under the classic business model and the ED;
- Undiscounted ultimate claim and claim expense reserves;
- Estimates of ultimate claims and claims expenses based on actuarially developed estimates where the objective is measuring a conceptual mean value;
- Settlement uncertainty incorporated into the measurement of ultimate claim and claim expense reserves without an explicit risk adjustment;
- *Extensive financial statement disclosure of the processes used to develop estimates of ultimate claim and claim expense reserves and the risks inherent in the claim and claim expense reserve estimation process;*
- *Clear linkage, in the United States, to Statutory Schedule P which provides loss development data by line of business and accident year;*

***Application B – Fulfillment Cash Flow Model***

- *Explicit risk adjustments and discounting must be incorporated into the measurement of claim and claim expense reserves where they are incorporated into the calculation of claim and claim expense reserves as part of an insurer's business model (i.e., incorporated into the underwriting, management and performance evaluation framework).*

Our proposal recognizes that while the majority of property-casualty insurers around the world follow a generally consistent measurement and reporting framework, there are a handful of jurisdictions (e.g., Canada and Australia) that do incorporate both discounting and risk margins into their insurance measurement and reporting frameworks. For those insurers and those jurisdictions, we believe it is necessary and appropriate to support symmetry between the measurement and reporting of insurance contracts for general purpose financial statements and the business model used to operate and manage the underlying insurance operations.

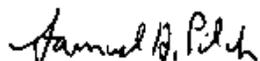
The integration of a business model approach into a converged DP and ED appears to be essential if a fundamental objective is to produce measurements and disclosures that are relevant and a faithful representation of the business activities they purport to represent. In short, the measurement and disclosure framework should compliment and clearly articulate the business model of insurers to permit investors and other financial statement users to better understand the key drivers of financial results and the risks to achieving those results. In contrast, a measurement and disclosure framework that is in basic conflict with the underlying business model will be unlikely to produce information for investors and other financial statement users that is relevant, representationally faithful, understandable and comparable.

Whether or not the Boards accept and implement our recommendations, we believe it is critical that a comprehensive field test of all significant components of the ED is completed along with a critical evaluation the results before final deliberations on a final standard takes place. The global insurance industry is much too important to adopt radical changes (including a move

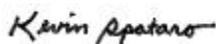
from separate models for life and non-life to a single integrated model) to the basic measurement and disclosure models without sufficient field testing through a variety of business cycles and environments and a thorough comparison to the accounting and reporting of similar instruments in competing industries such as banking and investment management. Moreover, the results of the comprehensive field tests must be shared with constituents in the most comprehensive and transparent manner possible.

Allstate's detailed responses to the questions posed in the DP are attached.

Sincerely,



Samuel H. Pilch  
Controller & Group Vice President  
The Allstate Corporation



Kevin Spataro  
Vice President- Accounting Policy & Research  
The Allstate Corporation

## Appendix

### Definition and scope

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

We do not agree that the terms “compensation” and “indemnification” have the same meaning and therefore object to the replacement of indemnification with compensation for non-life insurance contracts. Benefits paid according to non-life insurance contracts (e.g., property insurance) indemnify the policyholder for an insured loss and are intended to put the policyholder in the same position as prior to the loss. In contrast, benefits paid according to life-insurance type contracts compensate the beneficiary for an insured event (e.g., death) by providing a payment that cannot, and is not intended to, put the insured or the beneficiary in the same position they were in prior to the loss. The definition in the final standard should distinguish between compensation and indemnification because:

- (a) it represents a distinguishing factor between life and non-life insurance contracts;
- (b) it is not correct to characterize benefits under non-life contracts as “compensation”;
- and
- (c) not correcting a known basic flaw in the definition may lead to future issues that can be easily avoided

**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?**

Not necessarily. We believe the financial reporting of insurance contracts with the same characteristics should be consistent for all entities issuing those contracts. That said, it is a fact that all insurance contracts do not have similar risk characteristics and as a result different financial reporting models are required for life and non-life insurance contracts. Our concern, as a result of the IASB’s single insurance model proposal, is that some insurers (primarily life insurers with less significant non-life operations), are seeking latitude to apply a life insurance based model to their entire book of business, including their non-life business, which we believe is inappropriate inasmuch as it would reduce the relevance, comparability and understandability of the resulting financial statements.

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

We agree with the scope exclusions listed in Paragraph 28 of the DP.

**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?**

We believe employee benefits is an area that deserves separate consideration due to its unique attributes and significance.

## **Recognition and measurement**

### **7) Do you agree with the use of the probability-weighted estimate of net cash flows to measure insurance contracts?**

No. Fulfillment cash flows as defined in the ED are comprised of unbiased, probability-weighted cash flows, a current discount rate and an explicit risk adjustment. The non-life business model currently applied throughout most of the world relies on ultimate measures of premiums, claims and claims expenses to develop underwriting results and performance metrics. The following provides the rationale for this practice which has been in place, and operating effectively, for many decades:

- Probability-weighted cash flows are not utilized as it is not possible to reliably estimate the probabilities associated with the entire range of potential settlement scenarios (which is infinite) and the probabilities assigned cannot be fully tested before the environment changes enough to render the past data irrelevant to estimating the current risk;
- Undiscounted as opposed to discounted measures of cash flows are utilized in most cases, except where claims are reliably determinable on an individual claim basis, as it provides more transparency and understandability into the direct causes of changes in cash flow estimates (e.g., the frequency and severity of claims) to investors and other financial statement users;
- Explicit risk adjustments are typically not incorporated into the measurement of pre- or post-claim reserves as the remaining risk inherent in claim reserve measurements at the reporting date is not reliably measurable on an ex-ante basis (i.e., before the risk crystallizes). In contrast, uncertainty is incorporated into the measurement of non-life reserves as a result of the variety of actuarial process and practices used to develop claim and claim expense reserve measurements. The reasonableness and reliability of claim reserve estimates over time are evaluated against claim development experience as presented in the United States in Statutory Schedule P, which provides loss development data by line of business and accident year.

### **Does that approach faithfully represent the economics of insurance contracts?**

No. Non-life insurance claim and claim expense reserves cannot be reliably measured using probability-weighted cash flows as a result of the limitations described above. As a result, non-life insurers should continue to utilize an approach whereby claim and claim expense reserves are estimated using a variety of statistical and non-statistically based actuarial techniques to measure claim and claim expense reserves. This approach has been in use for many decades throughout most of the world and has been proven to be effective, understandable, and comparable.

### **Is it an improvement over existing U.S. GAAP?**

No. The measurement proposal set forth in the ED would not be an improvement over existing U.S. GAAP for a variety of reasons not the least of which is that the proposal would be in conflict with the business model of non-life insurers. In addition, the proposed model is based on untested theoretical assumptions which may or may not produce valid outputs in a variety of business environments and business cycles. Absent a sufficient amount of

empirical data to support the proposed measurement model, we support a continuation of the current approach which is based on rigorously developed actuarial estimates supplemented by appropriately constructed loss development schedules which objectively demonstrate the accuracy of actuarially determined estimates over time. In contrast, using probability-weighted cash flows does not faithfully represent the economics of non-life insurance claims liabilities and would not represent an improvement over existing U.S. GAAP.

In contrast to a measurement model based on fulfillment cash flows we recommend a measurement model based on the business model of non-life insurers. The basic business model of non-life insurers is to underwrite and manage portfolios of property-casualty risks and invest premiums to produce sufficient cash flows to settle policyholder claims as they come due pursuant to the underlying insurance contracts. The measurement model we recommend would be comprised of the following elements:

- A UPR during the coverage period. This would replace the PAA as set forth in the ED. The UPR measures the amount of premium allocable to the unexpired portion of the coverage period. The amount of UPR is an important measure as it represents the amount that would be fully refundable to the policyholder at any time and for any reason they may choose to terminate coverage during the coverage period.
  - The UPR is typically earned on a pro-rata basis over the coverage period as the risk protection is provided uniformly over the coverage period. For example, in the case of homeowners insurance, policies are typically multi-peril that cover wind, fire, theft and other named perils which typically do not exhibit any pronounced seasonality.
  - The UPR is presented on an ultimate basis. This is reasonable given that coverage periods are typically one year or less and the impact of discounting is immaterial.
  - Explicit risk adjustments are not separated from the measurement of the UPR as would be the case with the PAA which requires the continuous application of an onerous contract test. This is reasonable given the inability to reliably measure the risk inherent in a portfolio of non-life insurance contracts on an ex-ante basis.
- In the post-claim period, we recommend that claim and claim expense reserves be measured on a basis consistent with a non-life insurers business model. Accordingly, in situations where a non-life insurers business model incorporates discounting and explicit risk adjustments we would support application of the IASB's proposed fulfillment cash flows. In contrast, where the business model of non-life insurers utilizes ultimate measurements of claims and claims expenses (i.e., without discounting or explicit risk margins) which is the case for most of the world, we support the measurement of claims and claims expense reserves in a manner consistent with that business model.
  - Undiscounted measures provide more transparent, understandable information for investors and other users as they are representative of the actual amounts insurers expect to pay policyholders to settle claims that arise under the insurance contracts.
  - Claim and claim expense reserves based on rigorously developed actuarial estimates supplemented by loss development tables demonstrate an insurers

ability over time to accurately estimate reserves and meets the needs of investors and other financial statement users to assess the most critical balance sheet measurement of a non-life insurer (i.e., claim and claim expense reserves).

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

Not necessarily. While we believe explicit risk adjustments should be incorporated into the measurement framework for claims and claims expense when they are included in the business model of the reporting entity; this is typically not the case. Where explicit risk adjustments are not included in a non-life insurer's basic business model, they should not be incorporated into the required measurement framework as that would be inconsistent with the objectives of the Conceptual Framework. More specifically, the objective of the Conceptual Framework is to produce financial information for the benefit of investors and other financial statement users that is relevant and a representationally faithful depiction of the business activity it purports to represent, developed in a manner that supports the understandability and comparability of the information.

The objective of the explicit risk adjustment in the ED is to measure "the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected". The objective of the proposed risk adjustment is fundamentally inconsistent with the basic contract fulfillment notion implicit in the insurance business model in use throughout most of the world as insurance contracts generally cannot be transferred without obtaining required regulatory approvals, and transfers rarely occur because they are contrary to the intent and the business purpose of insurers. We believe that because the objective of the risk adjustment is based on concepts and cash flows that are not expected to occur, any measurement resulting from its application would not be either relevant or a representationally faithful depiction of the business activity it purports to represent.

In contrast to an explicit risk adjustment, the uncertainty inherent in the measurement of claim and claim expense reserves can be addressed in the following manner; consistent with the non-life business model in use throughout most of the world:

- Capture the uncertainty inherent in the measurement of ultimate claim and claim expense reserves through the application of actuarially-based methods, process, and practices for developing claim and claim expense reserves which utilize a variety of statistical and non-statistical techniques to derive periodic measurements of claim and claim expense reserves. Comprehensive disclosures of the techniques used to derive the estimates are disclosed together with robust information about the risks inherent in the estimation process and the measurement output. In addition, appropriately designed claim development tables would be provided which give investors and other financial statement users the most objective, transparent, understandable and comparable information about both the inherent risk in the claim and claim expense reserve estimation process and support for an individual insurers ability to accurately and reliably estimate claim reserves over an extended period.

**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?**

No. We do not believe the typical investor or other financial statement user would understand the objective of the risk adjustment. We believe the objective implies a “transfer” or “market” based measure as one would presumably need to calibrate to a market measure to determine the “maximum amount the insurer would rationally pay to be relieved of the risk”, however, this is fundamentally inconsistent with both the typical non-life insurers business model as well as the IASB’s fulfillment value notion.

In addition, we have additional insights into the question of whether the explicit risk adjustment can be operationalized as an official field testing company. Our preliminary field testing of the ED indicates that explicit risk adjustments derived using the three alternatives and a single set of claim data produces results that are non-comparable and the differences would not be understood by a typical investor or other financial statement user. In evaluating the ED’s explicit risk adjustment proposal from a field test perspective, the issue that emerges is that if comparability and understandability are required attributes, then prescribing a specific method and set of assumptions for all similar insurers and insurance products would appear to be necessary, however, the objective of defining “similar insurers and similar insurance products” would likely be little more than an aspirational goal. Alternatively, allowing individual insurers to choose their own risk adjustment technique means that similar insurers with similar insurance products may choose different techniques to determine explicit risk adjustments and it would not be possible for investors or other financial statement users to reconcile the computed risk adjustments.

Other significant issues with the explicit risk adjustment for non-life insurers include the need to use a “bootstrapping” model to derive the risk adjustment. However, given the truly dynamic nature of non-life insurance contracts, the historical information utilized in the bootstrapping exercise may not be indicative of the expected future results of current contracts which require the reporting entity to make changes to the historical data. These changes are highly judgmental, numerous, and not likely to be either transparent to, or otherwise understood by, investors or other financial statement users.

As it relates specifically to the computation of explicit risk adjustments as proposed in the ED, it is critical that extensive field testing be completed and carefully evaluated to determine whether (a) the basic objective of the explicit risk adjustment is appropriate, (b) if appropriate, whether the objective can be achieved with one of the three measurement alternatives provided in the ED, or a yet to be identified alternative, and (c) whether explicit risk adjustments computed would be both comparable between insurers and understandable by investors and other financial statement users. The mere fact that these questions must be posed suggests that a substantial amount of work must be completed before the ED can progress toward finalization.

At the same time, application of the well-understood, time-tested measurement model currently utilized throughout most of the world, supplemented by appropriately designed claim development tables, is an appropriate alternative to the un-tested conceptual model.

The existing non-life methodology has the benefit of being time tested, reliable, effective, understandable, comparable, relevant and representationally faithful.

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

While the intent in proposing to limit the estimation techniques is to force a degree of comparability among the risk adjustments reported by different entities, based on our preliminary field testing results, increased comparability will not result from imposing these limitations. The reported risk adjustments will still vary widely depending on the assumptions and multitude of other subjective judgments that each entity must make in estimating the risk adjustments.

If the financial reporting standard were to compel entities to use the same or very similar assumptions and to eliminate or substantially reduce the judgments that entities could apply, the results may not faithfully represent the risks represented in each insurer's insurance contracts. Recognizing the limitations of explicit risk adjustments for non-life insurance, we believe that the focus should shift to providing more meaningful descriptions of risks inherent in various insurance contracts through more complete qualitative and quantitative disclosures specific to each insurer's business model and portfolios of risks.

**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?**

As described in more detail above, we do not support the mandatory application of a building block measurement model to all non-life insurance contracts. The financial reporting standard should not require or imply the need for a probability weighted methodology to estimate cash flows for all non-life insurance contracts as it is not possible to reliably estimate the probabilities associated with the entire range of potential settlement scenarios (which is infinite), and any probabilities that are assigned cannot be fully tested before the environment changes enough to render the past data irrelevant to estimating the current risk.

Non-life insurers should be permitted to utilize a measurement approach whereby claim and claim expense reserves are estimated using a variety of statistical and non-statistically based actuarial techniques. Assuming the measurement objective is for the estimated cash flows to represent a mean outcome, then the financial reporting standard should explicitly state this principle which is consistent with many of the actuarial techniques in use around the world today.

**12) Do you agree that the carrying amount of all insurance contracts should be discounted if the effect is material?**

We believe the discounting non-life claim and claim expense reserves should be required when claims and claims expenses are reliably determinable on an individual claim basis or where claim and claim expense reserves are discounted as part of a non-life insurers business model.

**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?**

In situations where the claim and claim expense reserves of non-life insurers are discounted we believe the discount rate should be determined in a practically expedient manner. For example, a discount rate based on AA Corporates matched to the expected duration of the reserves could be such a practical expedient.

We believe the guidance in the ED for determining the discount rate that starts with a risk free rate and adds a liquidity adjustment is unnecessarily complex and would likely lead to the determination of discount rates that are neither understandable or comparable.

**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?**

Yes. We agree that acquisition costs should be included as one of the cash flows relating to the contract, however, netting incremental acquisitions costs against the liability (as opposed to the current practice of separate presentation) impairs the presentation of premiums as a primary performance metric and could destroy comparability across the non-life insurance industry.

**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?**

Acquisition costs included should be incremental to the insurer at the portfolio level (rather than at the level of individual insurance contracts, as proposed in Paragraph 59 of the DP). Limiting acquisition costs to be included in the initial measurement to those that are incremental at the individual contract level would discriminate between insurers based on the form of distribution utilized. Measurement on this basis would lead to different reported liability values based on how the contracts were distributed, even if the expected future cash flows on the obligations are the same.

The guidance recently issued by the FASB in ASU 2010-26 (*Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*) provides a reasonable basis for determining acquisition costs that could be included in the initial measurement. ASU 2010-26 does not determine the deferability of acquisition costs based on the form of distribution and also allows insurers to immediately expense acquisition costs, even though such expenses may otherwise be eligible for deferral.

**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?**

We support the application of a measurement model that is consistent with the business model of non-life insurers. The most prevalent business model for non-life insurance in place throughout most of the world does not include explicit margins (or discounting) in the pre- and post-claim periods. Under the most prevalent business model, premiums are

earned on a level basis consistent with the provision of risk protection over the coverage period. Concurrent with the earning of premiums over the risk protection/coverage period, claims, claims expenses and other expenses are also recognized on an ultimate basis during the coverage period. At the end of the coverage period all revenues, expenses, and profit related to the contract is recognized. Subsequent to the end of the coverage period, incurred but unpaid claim and claim expense reserves are continuously re-estimated and any adjustments (either positive or negative) are immediately recognized as positive or negative reserve development.

Consistent with our support for a business model approach, we support allowing insurers who currently utilize explicit risk adjustments in the measurement of claim and claim expense reserves to be allowed to continue to utilize those measures.

We note that the DP's composite margin proposal was not designed with the intent of application to non-life insurance contracts. Accordingly, in the event the composite margin approach were to be mandatorily applied to non-life insurance contracts we believe the profit recognition formula would need to be modified as it would significantly delay profit recognition beyond the period where all risk protection services are provided under the non-life insurance contract.

**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?**

No. The method of releasing the composite margin would not be appropriate for most non-life insurance contracts, although it may work for insurance contracts where there is little difference between the coverage and claim settlement period. The profit inherent in a portfolio of non-life insurance contracts should be released over the period that risk protection services are provided (i.e., over the policy coverage period). Profit should not be deferred and recognized over the claim settlement period as settling claims is solely an administrative service and not representative of the risk of providing insurance protection during the contractual coverage period. Moreover, the recognition of profit over the policy coverage period ensures symmetry in the recognition of total premiums revenues and ultimate expenses related to portfolios of insurance contracts.

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

No. We do not support the accretion of interest on margins as that would add unnecessary complexity to a proposed measurement model that is already complex to the extent it includes both explicit risk adjustments and discounting.

**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?**

A modified approach for non-life insurance contracts is necessary and should be based on an insurer's business model to ensure consistency with the requirements of the Conceptual Framework; i.e., the presentation of financial information that is relevant and a faithful representation of the business activities it purports to represent.

We support a required simplified measurement approach that is consistent with the business model for non-life insurers. We believe the measurement model for non-life insurers should have two distinct application alternatives. One alternative would be a combination of the UPR during the coverage period and an ultimate claim and claim expense measurement model that utilizes ultimate values that are consistent with the actual amounts the insurer expects to pay to settle claims with policyholders as they arise pursuant to the terms of the contracts. The second alternative would be application of the fulfillment cash flows as proposed in the IASB's ED.

Application of one of the two non-life alternatives would be required. However, because the requirement is to follow a measurement application consistent with the insurer's business model, there should be universal support for this requirement.

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

We recommend replacing the PAA with the globally recognized, inherently simple, UPR approach that has been in use throughout most of the world for many decades and has performed very well throughout a variety of business cycles and environments. At the same time, for non-life insurers whose business model incorporates discounting and explicit risk adjustments in the underwriting, management, and performance evaluation, they would be permitted to apply the fulfillment cash flow model as proposed in the ED.

For non-life insurers whose business model results in applying the UPR approach, insurance premiums received prior to the inception of the coverage period should be reported as Advance Premium. At the inception of the coverage period, any Advance Premium plus the remaining premium for the contract term, whether collected or not, would be reclassified to UPR, and then earned on a pro-rata basis over the coverage period consistent with the provision of insurance risk protection.

Claims and related claims expenses for non-life insurers would be measured in a manner consistent with the insurers underlying business model which would result in the application of one of the following two measurement approaches:

- A. For non-life insurers that do not incorporate discounting or explicit risk margins in the underwriting, management, and performance evaluation of their business, claims and claim expenses would be measured on an ultimate (i.e., undiscounted) basis consistent with their business model, and appropriately designed claim development tables would be constructed and presented (by line of business and accident year) to allow investors and other financial statement users to assess the reliability of management's reserve estimates over time. Claim development tables would be used instead of explicit risk adjustments as the primary tool to convey both the inherent risk in specific reserve estimates as well as a specific insurer's ability to accurately estimate claim and claim expense reserves over time.
- B. Fulfillment cash flows as proposed in the ED

For the items specifically noted in Paragraph 106:

- a. The UPR should not be reduced at inception by the incremental acquisition costs; our preference would be to present acquisition costs separately. All premium would be earned, and UPR released, over the coverage period.
- b. Interest would not be accreted on the carrying amount of the pre-claim liability.
- c. Losses would be recognized immediately for contracts that are determined to be onerous; but this would rarely occur during the relatively short coverage period. It would be unusual for substantial credible changes to occur over this short period that would cause contracts to become onerous.
- d. Presentation in financial statements should be consistent with the presentation framework currently in place in the U.S. Premiums should be presented on an earned basis, with separate reporting of unearned premium reserves and claim reserves as well as uncollected premium balances.

**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?**

No. The building block model, as currently constructed, if it were mandatorily required to be applied to non-life insurance contracts would not produce relevant information to help investors and other financial statement users of a non-life insurer's financial statements make economic decisions as it typically would not produce measurements that are a faithful representation of the non-life insurance business model. Moreover, the increased level of complexity and subjectivity, the effects of which have not been adequately field tested, would reduce the understandability of non-life insurer's financial statements and make them less comparable between non-life insurers, both within specific geographic jurisdictions and across global geographic jurisdictions.

We support retaining the time tested, inherently simple, UPR approach as opposed to the proposed PAA for the following reasons:

- The benefit of mandatory discounting of future premiums arising within insurance contracts with a coverage period of approximately one year or less does not exceed any reasonable cost-benefit threshold and is generally inconsistent with the typical non-life business model in place throughout most of the world;
- The requirement to apply an explicit risk margin based on the "amount the insurer would rationally pay to be relieved of the risk that the ultimate cash flows exceed those expected" both in the pre- and post-claim period introduces a transfer or exit based objective to the measurement of insurance contracts which is inconsistent with the non-life insurance business model in place throughout most of the world.
  - Moreover, in the absence of markets to which "the maximum amount the insurer would rationally pay to be relieved" can be calibrated, the risk adjustment is simply a hypothetical calculation that can be arbitrarily set by individual insurers and therefore lacks relevance, representational faithfulness, comparability and understandability;
- The computation of claims and claims expenses using the present value of future cash flows requires "an explicit, unbiased and probability-weighted estimate of the future cash outflows less the future cash inflows that will arise as the insurer fulfills the insurance contract". We do not support the required use of probability-weighted cash

- flows (“PWCFs”) due to the nature non-life insurance contracts (i.e., the infinite range of potential settlement outcomes when claims are initially reported as well as when they are incurred but not reported). PWCFs require constructing the range of all possible future settlement amounts together with an assignment of probability weights to each possible future settlement amount. We do not believe it is possible to reliably predict the probabilities associated with the entire range of potential settlement scenarios (which is infinite) and any probabilities assigned cannot be fully tested before the environment changes enough to render past data irrelevant to estimating current risk;
- Netting incremental acquisitions costs against the UPR (as opposed to the current practice of separate presentation) impairs the presentation of premiums as a primary performance metric and measuring premiums net of acquisition costs could destroy comparability across the industry.

### Why or why not?

The non-life business model in place throughout most of the world focuses on key metrics such as underwriting income (loss) which is composed of earned premiums, claims and claims expenses, and operating expenses, all measured on an ultimate (i.e., undiscounted) basis. The existing non-life model, which has been in place and functioning very well for many decades, recognizes that the most critical measurement for non-life insurers is the ultimate amount of claim and claim expense reserves (i.e., the actual amount expected to be paid to settle claims with policyholders pursuant to contractual terms). Ultimate amounts (i.e., undiscounted and without risk margins) are used not only because they represent the amounts actually expected to be paid to settle claims but also because:

- a) For short-tail claims the impact of discounting is immaterial and for long-tail claims, while the amount of loss may be reliably estimable, the timing of payments is not;
- b) It is not possible to reliably measure the risk inherent in a portfolio of non-life insurance contracts on an ex-ante basis (i.e., before the risk crystallizes) as is proposed in the ED.

The business model of non-life insurers is to underwrite and manage portfolios of risk and concurrently invest premiums to produce cash flows necessary to settle claims as they arise pursuant to the terms of the underlying insurance policies. Recognizing the fundamental attributes of the non-life business model, together with the practical limitations of introducing explicit risk adjustments and a greater amount of discounting, we believe the Boards should modify their existing proposals to incorporate a business model driven application alternative for non-life insurers. A non-life focused business model application alternative is vitally important as accounting guidance should never require a business enterprise to measure and report its business activities in a manner fundamentally inconsistent with its business model. This would be diametrically opposed to the Conceptual Framework objective of producing information that is relevant and a faithful representation of underlying business activities.

The non-life insurance application alternative we propose, which would only be available to insurers who meet the designated business model criteria, would have the following attributes:

- a) **Discounting**; provided discounting is incorporated into the insurer’s business model (i.e., it would need to demonstrate that it underwrites, manages, and evaluates performance on a discounted basis);

- b) **Explicit Risk Adjustments**; provided explicit risk adjustments are incorporated into the insurer's business model (i.e., the insurer would need to demonstrate that explicit risk adjustments are utilized to underwrite, manage, and evaluate performance)

Our recommendation is to **require** non-life insurers to measure and report the business activities in a manner consistent with their business model. Accordingly, in situations where discounting and/or explicit risk margins are not part of a non-life insurers basic business model in both the pre- and post-claim period they would not be required to be incorporated into the insurer's accounting and reporting model to ensure the accounting and reporting of its business activities is faithfully represented in its general purpose financial statements. Moreover, as the PAA does not appear to meet the requirements of a simplified approach, we recommend replacing it with the UPR which has been in place for decades and functioning very well. In addition, if explicit risk adjustments are not present in a non-life insurers business model, we propose that the level of uncertainty in recorded reserves be identified through the use of properly constructed claim development tables which would allow investors and other financial statement users to evaluate management's ability to adequately establish reserve estimates can be evaluated in a more objective, reliable, and comparable manner.

The benefits of our proposal are as follows:

- a) **No optionality** – insurers would be required to measure and report their insurance business in a manner consistent with their business model;
- b) **Relevance and Representational Faithfulness** – insurers would be required to account for and report their business activities in a manner consistent with their business model. This will ensure that general purpose financial reporting provides information to investors and other financial statement users that is a faithful representation of the underlying business activities and therefore relevant;
- c) **Understandability and Comparability** – to the extent insurers are not required to implement complex, insufficiently field-tested, hypothetical proposals, the understandability of insurer financial statements will benefit as will the comparability of insurer financial statements both within, and across, geographic jurisdictions.

**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)?**

The scope of insurance products for each approach should be as defined in current U.S. GAAP (in Paragraphs 7 and 8 of Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprises*; Codification Sections 944-20-15 and 55).

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

As discussed herein we do not believe the building-block approach nor the modified approach (as described in the ED) would provide decision-useful information for most non-life insurance contracts as both are generally inconsistent with the non-life insurance business model in place throughout most of the world.

We do not believe the building blocks model would increase the understanding of the risk inherent in claim and claim expense reserves for non-life insurance contracts as compared

to the current U.S. GAAP model which is time-tested and which investors who follow the non-life insurance businesses understand and prefer to retain. The current model is widely understood and is the primary model used in most of the world.

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

Since the U.S. GAAP model is widely used globally for non-life insurance contracts, the model's merits have already been substantiated. Investors have not asked for significant changes to the U.S. GAAP accounting model for short-duration non-life contracts; although targeted changes to improve U.S. GAAP should be considered such as the introduction of claim development tables constructed by line of business and accident year.

Whatever modifications the Board considers it must ensure that any and all changes conform to the business model of non-life insurers as it is vitally important that accounting guidance never require a business enterprise to measure and report its business activities in a manner fundamentally inconsistent with its business model.

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

Field testing has been extremely limited and as such the incremental costs of adopting alternatives described in the DP remain unclear. Broad conclusions about the benefits or the costs of implementing the proposed standard cannot be substantiated before the completion of comprehensive field testing.

Notwithstanding the preceding, incremental one-time costs of adopting the alternatives as described in the DP would include but not be limited to:

- developing newly defined inputs to be utilized in new estimation models ; developing new liability estimation models for a modified premium approach, for changes in claim liability measurement, and increased use of stochastic approaches at a minimum;
- developing new ways of capturing data and manipulating it in newly defined ways; developing a new framework for presentation and disclosure and redesigning general ledger data and financial reporting systems to feed into the new framework; developing new definitions and data collection and interface procedures for incremental acquisition costs (at the individual contract level).

Significant one-time costs would be incurred in educating management and investors and training staff. In addition, higher ongoing costs of measuring and reporting in accordance with the new standard, as proposed, would be expected due to the added complexity of the proposed models and in some cases their inconsistency with the non-life insurance business model. We expect financial results reported under the proposed standard would be more volatile, and much more analysis would be required to understand and explain the financial statement results.

## **Reinsurance**

**25) 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?**

No. Similar contracts should be measured consistently, regardless of the holder of the contracts. Insurance contracts held directly by policyholders should not be excluded from the scope of the proposed guidance.

**26) Should there be symmetry between the recognition and measurement of reinsurance contracts and the underlying contract ceded?**

Yes. Symmetry should exist between the recognition and measurement of reinsurance contracts and the underlying ceded business. The reinsurance proposals should specify that the measurement of the reinsurance contract should be consistent with measurement for the associated direct insurance.

According to proposals in the ED, reinsurance of certain direct written non-life insurance contracts measured under the PAA would be measured using the building blocks approach if the term of the reinsurance contract is greater than approximately one year. Additional inconsistencies between the measurement of reinsurance and direct non-life insurance contracts may arise due to differences in assumptions and timing of recognition (e.g., the reinsurance agreement covers direct insurance contracts not yet written or recognized by the ceding company).

In addition, netting reinsurance commissions against reinsurance premiums pursuant to Paragraph 46 is not appropriate, especially for quota share reinsurance arrangements. Such netting would inappropriately alter the underwriting component metrics (loss ratios, expense ratios, and underwriting profit ratios) between direct and net business.

## **Presentation and disclosure**

**27) 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.**

No. The summarized margin presentation would be less useful to users of financial statements than the approach currently in place in most of the world for presenting information about non-life insurance contracts. Furthermore, based on proposals in the ED, the summarized margin presentation would be used for claim liabilities of these contracts, but would not be used for pre-claim liabilities of most non-life insurance contracts (those subject to the PAA). Applying different measurement and presentation bases to different liabilities arising from the same contracts would be confusing and not decision-useful.

We are particularly concerned that the summarized margin presentation would not tie to the key performance measures and information in claim development tables. The face of the financial statements should include important information about premiums and claims.

This information is critical for users to understand the overall volume, growth, loss ratios, and claims developments; all key measures of performance for non-life insurers.

The proposed presentation requirements call for reporting either a net asset or net liability for each insurance portfolio. This would not provide useful information on the face of the financial statement particularly for non-life insurance contracts. Users benefit from separate reporting of UPR, claim and claim expense reserves, and uncollected premiums. Moreover, there is no right of offset between assets receivable from one policyholder with a claim obligation owed to or on behalf of another policyholder. Loss reserves and unearned premium reserves for non-life insurance contracts convey important information to users. A net presentation of such items would result in a significant reduction of decision useful information on the face of the balance sheet.

**28) 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)?**

As described above, we do not support a margin presentation approach or a building block measurement approach for most non-life insurance contracts.

**29) Should short- and long-duration (or non-life and life) contracts be presented in a similar manner if such contracts are measured under different approaches?**

We support the measurement and presentation of insurance contracts consistent with the underlying business model. In most cases the business model for life and non-life insurance contracts will not be the same and therefore the method of presentation should not be the same as it would not be a faithful representation of the underlying business activity.

**30) 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?**

The specific disclosure requirements should support the measurement principles, once determined, at a level that provides sufficient and meaningful information to financial statement users at a justifiable cost to preparers.

In general, the proposed disclosures appear overly burdensome, and generally ignore the relationship between the benefit of the information and the time and cost of preparation. For example, the proposed detail disclosure requirements around explicit risk adjustments would be overly burdensome and complex and may inappropriately imply a level of achieved precision in the estimation of risk adjustment than actually exists. The prior statement is supported by our preliminary field testing results.

Certain disclosures (e.g., the sensitivity analysis) appear too detailed and conceptual. Detailed disclosure requirements should be readdressed after the measurement model is re-deliberated.

The proposed reconciliation of all components of the insurance liability, including the risk adjustment and residual margin, would not be helpful to investors and other financial statement users in understanding the amount, timing, and uncertainty of actual cash flows for non-life insurance contracts (the most relevant information in understanding and measuring the performance of an insurance entity) unless the insurers business model includes those attributes.

We are concerned that the proposed disclosures may impair financial statement users ability to understand the amount, timing, and uncertainty of future cash flows arising from insurance contracts due to the volume of information and the potential that the disclosures may not be consistent with the insurers basic business model. Accordingly, the disclosure requirements for non-life insurance contracts should focus on information about the entity's underwriting, risk management, and claim estimation practices and the results thereof and should include the key drivers of the business: premiums, claims and claims adjustment expenses, acquisition and other expenses, and claims development tables.

**Additional question for respondents**

**31) 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 in 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.

With the primary concern being the need for separate measurement models for life and non-life insurance contracts, of the five choices listed, the appropriate incremental improvements could best be achieved through choice e) for non-life insurance contracts (make targeted changes to address specific concerns about current U.S. GAAP). The current U. S. GAAP standard has been proven to be effective for non-life insurance contracts, not only in the U.S., but globally as well.

The non-life insurance application alternatives we propose, which would only be available to insurers who meet the designated business model criteria, would have the following attributes:

- a) **Discounting**; provided discounting is incorporated into the insurer's business model (i.e., it would need to demonstrate that it underwrites, manages, and evaluates performance on a discounted basis);
- b) **Explicit Risk Adjustments**; provided explicit risk adjustments are incorporated into the insurer's business model (i.e., the insurer would need to demonstrate that explicit risk adjustments are utilized to underwrite, manage, and evaluate performance)

Our recommendation is to require non-life insurers to measure and report the business activities in a manner consistent with their business model. Accordingly, in situations where discounting and/or explicit risk margins are not part of a non-life insurers basic business model in both the pre- and post-claim period they would not be required to be incorporated into the insurer's accounting and reporting model to ensure the accounting and reporting of its business activities is faithfully represented in its general purpose financial statements. In addition, if explicit risk adjustments are not present in a non-life insurers business model, we propose that the level of uncertainty in recorded reserves be identified through the use of properly constructed claim development tables which would allow investors and other financial statement users to evaluate management's ability to adequately establish reserve estimates can be evaluated in a more objective, reliable, and comparable manner.

The benefits of our proposal, as more fully described in the response to Question 21, are as follows:

- a) ***No optionality***
- b) ***Relevance and Representational Faithfulness***
- c) ***Understandability and Comparability***

As the FASB will soon re-deliberate with the IASB on a converged global standard based on the comment letter responses, we encourage you to advocate for the current principles embedded in U.S. GAAP for non-life insurance contracts as these principles have been proven effective over many decades of use and under a variety of extreme circumstances and have proven to provide useful information to regulators, investors and other financial statement users, not only in the U.S., but globally as well.