

# OIL INSURANCE LIMITED

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December 15, 2010

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

## **File Reference No. 1870-100**

### **Re: Discussion Paper – Preliminary Views on Insurance Contracts**

Dear Sirs,

Oil Insurance Limited (“OIL” or the “Company”) appreciates the opportunity to comment on the Discussion Paper – Preliminary Views on Insurance Contracts (the “Discussion Paper”). OIL was incorporated under the laws of Bermuda on December 14, 1971 and carries on business as an insurance and reinsurance company insuring specific property, pollution liability, control of well and other similar risks of its members. The members comprise companies in the energy industry. The Company holds a Class 2 license under The Insurance Act 1978 of Bermuda and related regulations. Coverage provided to each insured is limited to \$250 million per occurrence. There is no annual aggregate limit for each insured, however, there is an aggregation limit in place for multiple claims arising from a single occurrence of \$750 million. Our gross premiums written totaled \$891 million for the year ended December 31, 2009 and our shareholders’ equity was \$2.5 billion at December 31, 2009. We prepare our consolidated financial statements in accordance with generally accepted accounting principles in the United States of America (“GAAP”).

We support the FASB's objective of working with the IASB to develop converged standards, including a standard on accounting for insurance contracts. We believe that convergence to a single set of high quality accounting standards will benefit the global capital markets and the financial statement users who participate in those markets. We believe the FASB should continue to work with the IASB in evaluating and making changes responsive to comments received, resolving current differences between the Boards, and developing a global insurance standard. In addition, due to the pervasiveness of the proposed changes, we recommend the Boards work closely with the insurance industry to comprehensively test the proposals using real data before finalizing the standard. This would help to ensure that the model will produce information that is relevant to the decision making needs of users and is cost effective for preparers.

Detailed below are our comments on each of the questions outlined in the Discussion Paper. Where a question is either not applicable to the insurance contracts that we offer, or where we do not have a strong opinion on the question posed, our response is “No comment.” It is important to note that our comments are exclusively focused on property and casualty insurance contracts. We are not providing comments with respect of long-duration or life insurance products.



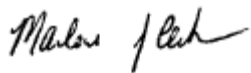
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Overall, we have three main comments on the Discussion Paper:

- We support targeted amendments to GAAP targeting property and casualty insurance contracts, rather than a comprehensive revision in insurance contract accounting as proposed in the Discussion Paper. While we understand the FASB's objectives underlying the Discussion Paper (transparency, comparability and decision usefulness), we believe existing GAAP meets those objectives and is well understood by the preparers and users of financial statements. If specific areas need to be addressed, we believe the FASB should target only those areas;
- The estimated costs to implement the building blocks model for the property and casualty insurance industry will be significant as the systems and data to meet the requirements do not currently exist and the cost to develop the systems and produce the data in a well controlled compliant manner, in our opinion, will significantly exceed the perceived benefits.
- The building blocks model will result in catastrophe or event-driven losses, such as those arising from hurricanes, earthquakes and other natural and manmade catastrophes, being recorded in financial statements before the underlying events take place and, in many cases, for events that may never take place during the coverage period, resulting in significant additional judgment and subjectivity involved in the financial statement preparation process that will impair consistency and comparability and provide less decision-useful information to the users of financial statements; and

We appreciate your consideration of our comments on the Discussion Paper. If there are any questions regarding this letter or you wish to discuss our comments and recommendations, please contact me at +1 441 278 1130 or at [marlene.cechini@omsl.bm](mailto:marlene.cechini@omsl.bm).

Sincerely,



Marlene J. Cechini  
Controller and Assistant Secretary

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### Definition and Scope

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

The proposed definitions of insurance contract and insurance risk are understandable and operational and are an improvement to existing GAAP.

**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?**

GAAP will be improved by the expanded scope of the insurance contract definition provided it increases consistency between entities in different industries that issue similar products.

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

We support the proposed scope exclusions, however, we believe it is important to allow for the continued use of the fair value option under ASC Topic 825 *Financial Instruments* for insurance contracts. For example, reinsurance can be purchased in the form of a catastrophe bond or a catastrophe swap that pays based on industry losses, and under existing GAAP, these types of structures are typically accounted for at fair value and are often purchased by hedge funds or other capital market participants. Under the proposed new definition of an insurance contract and insurance risk, these contracts would likely be required to be accounted for as reinsurance.

**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?**

No, employee benefits that contain insurance features should be subject to accounting principles used for all employee benefit plans rather than insurance contracts. .

**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?**

No comment.

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

Yes. If a component is not closely related to the insurance coverage specified in a contract it should be unbundled, however, we would not anticipate that there would be any components in a property and casualty insurance contract that would require unbundling.

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### 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?**

No. In relation to property and casualty insurance contracts, we do not believe the probability-weighted estimate of net cash flows as defined in the Discussion Paper is an improvement over current GAAP.

Our main concern is that for property and casualty insurance contracts that contain an element of catastrophe risk, the current definition of “probability-weighted estimate of net cash flows” would require losses associated with infrequent, but severe events to be recorded before the event giving rise to the loss has occurred. In many cases, the probability of these events occurring during the coverage period is remote, but the potential impact is severe, and as a result, all of the net cash flows associated with those risks would need to be reversed if the event did not occur. Since these events are remote, by definition, the most likely scenario is that the event will not occur during the coverage period and the net cash flows will need to be reversed by the end of the coverage period. However, although the events are remote, they are severe, and even on a probability weighted basis the net cash flows associated with these low frequency, high severity losses are material. If the event does occur during the coverage period the cash flows will likely deviate significantly from the expected outcome and will need to be adjusted significantly to the actual estimated losses.

We strongly believe that accounting for infrequent, but severe losses, such as hurricanes, earthquakes, and other natural and manmade catastrophes in financial statements before the event giving rise to the loss has occurred does not provide decision useful information to users of financial statements. We strongly believe that if a building blocks model is used, that these cash flows should be estimated and included in the net cash flows after the event giving rise to the loss occurs. By requiring the accounting for modeled expected catastrophe losses in financial statements, rather than actual incurred catastrophe losses, we believe the financial statements will be less useful because the financial statements will contain significant judgments about events that have not occurred and may never occur during the coverage period. In addition, although there is considerable science around catastrophe modeling, individual companies and catastrophe risk modeling firms have very different views about these risks. The catastrophe models are updated frequently, use simulations to model extreme events that have not occurred, and while important to overall risk management, we believe these models are not appropriate for use in the preparation of general purpose GAAP financial statements. The significantly differing views of catastrophe risk among market participants will result in very different net cash flows between companies exposed to the same underlying risks.

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

No, we do not believe that an entity’s estimate of the net cash flows should include a risk adjustment margin. We believe the use of a risk adjustment margin in GAAP financial statements will add an unnecessarily subjective calculation that will further impair consistency and comparability.

**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?**

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No. We believe the risk adjustment margin definition when combined with probability weighted expected future cash flows and discounting implies an exit value or fair value model for insurance accounting rather than a contractual fulfillment model. Insurance contracts are not traded. The cash flows associated with the rights and obligations of an insurance contract are settled between the insurance company and the policyholder at nominal values, not risk adjusted discounted values. Even when an insurance company enters into a reinsurance contract to cede a portion of its risk to a third party the insurance company is legally still a party to the underlying insurance contracts and is required to continue to service its policies and settle all claims. We believe the techniques used to estimate the risk adjustment margin will result in a wide degree of variation between insurers. In addition, there is no guidance on the confidence level within the Discussion Paper. For example, if a distribution were able to be constructed around the expected net cash flows the outcome for calculating a risk adjustment margin using a confidence level at the 75th, 90th, 95th, 99th, 99.5th or 99.8th percentile would presumably have very different results.

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

No, the subjective nature of the risk adjustment margin combined with the significant reliance on insurer specific inputs will result in a lack of comparability between insurers. The risk adjustment margin is a highly subjective calculation, it is not currently a concept that is used in practice, lacks specificity and we believe that it would likely be applied inconsistently between companies and impair consistency and comparability.

### **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?**

We do not agree with the description of cash flows to be included in the measurement model.

### **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?**

No. For property and casualty short duration insurance contracts we believe in accounting for the contractual cash flows on a nominal basis. The cash flows associated with the rights and obligations between an insurance company and the policyholder are fulfilled based on nominal, not discounted, cash flows. We do not consider investment income when pricing our insurance policies and one hundred percent of any discount recorded in the financial statements will reverse and be \$nil when the cash flows are ultimately settled. As such, we do not believe in discounting property and casualty net cash flows.

While we support full fair value accounting for investments in large part because there is an active market for these assets and they are traded, as well as supporting the elimination of accumulated other comprehensive income and requiring that the entire change in fair value of investments be recorded in earnings, we believe that a true contract fulfillment model for insurance contracts should be used.

We believe that discounting property and casualty reserves will add additional non-cash subjectivity to the financial statements of insurance companies. Discounting requires the estimation of not only the amount, but the timing, of the cash flows. In the property and casualty insurance business the timing of the cash flows is uncertain. Introducing discounting will increase subjectivity, create unnecessary complexity, result in the addition of significant additional capital to insurance company balance sheets that is not tangible and will not be realized, and has the potential to further impair consistency and comparability between companies.

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**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?**

We do agree that acquisition costs should be included in the initial measurement of the insurance contract.

**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?**

We 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.

**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 do not believe that either approach improves GAAP for property and casualty insurers. If we had to choose between the two alternatives we would prefer the composite margin approach which would enhance consistency and comparability over the two-margin approach.

**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, we believe that for property and casualty insurance contracts the composite margin should be recognized pro-rata over the coverage period.

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

We agree that interest should not be accreted on the composite margin. Accreting interest on the composite margin adds additional complexity and subjectivity into the financial statement preparation process and would not improve the decision usefulness of the financial statements.

**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?**

There are distinct differences between life insurance contracts and property and casualty insurance contracts. Current GAAP has developed over several decades, resulting in the emergence of a number of separate and unique accounting models that address short-duration contracts, long-duration contracts, reinsurance contracts and multi-year retrospectively rated insurance contracts. These products are different and the accounting models have emerged over time to meet the needs of the users and preparers of the respective financial statements. We believe that current GAAP provides appropriate guidance to prepare meaningful and useful financial statements for both short-duration contracts and reinsurance contracts.

**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)?**

We believe the current GAAP guidance for both short-duration contracts and reinsurance contracts which uses an incurred loss model and an unearned premium approach in the pre-claims period is appropriate. We also believe this model is widely used outside of the U.S. for short-duration property and casualty insurance contracts and is well understood by preparers and users of financial statements.

**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?**

We do not believe that the building-approach or modified approach in their current form produce relevant and decision-useful information. Our fundamental concern is that the additional complexity and subjectivity that arises from these models will impair consistency and comparability between companies. Under current GAAP, by far the most significant judgment made by the management of an insurance company is the estimate of the ultimate settlement and administrative costs for unpaid claims and claim expense arising from insurance contracts issued (i.e. reserve for claims and claim expenses). The proposed building blocks approach will introduce the following additional judgments into the financial statement preparation process:

- a. Estimates of cash flows for infrequent, but severe events that could occur, but have not yet taken place;
- b. Timing of cash flows;
- c. Discount rates by currency;
- d. Illiquidity premiums by currency; and
- e. Risk margins by portfolio.

Any one of these new judgments is significant and will have a material impact on the financial condition and performance of an insurance company.

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**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)?**

We believe the short- and long-duration definitions as provided for in ASC Topic 944 *Financial Services – Insurance* are clear. We do not think a bright line approximately one year rule should be used. While most property and casualty insurance contracts provide coverage for one year, there are times when the coverage period is longer (for example, a contract written on a risks attaching basis). We do not believe the accounting for these types of contracts should differ from the accounting for contracts that have a one year coverage period, as the underlying risks are the same.

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

Yes, we do not believe that decision-useful information would be provided by the highlighted approaches for short-duration property and casualty insurance contracts.

**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?**

No comment.

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

If a targeted approach is taken to improve the GAAP measurement model for insurance contracts, the targeted changes noted on pages 3 and 4 of the Discussion Paper would improve and simplify GAAP with the exception of discounting for short-duration contracts.

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

We would incur significant one-time and ongoing costs associated with adopting the guidance outlined in the Discussion Paper. The most significant costs will be associated with information systems which would need to be redesigned to accommodate the new accounting and financial reporting requirements. Additionally, there will be significant internal and external costs with training, education, consulting, auditing and other functions that will be related to implementing the new standard

**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?**

We believe the scope of the Discussion Paper should apply to all assumed and ceded reinsurance contracts. We do not have an opinion on whether the standard should address policyholder accounting.

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



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Yes. We believe that there should be symmetry between the recognition and measurement of reinsurance contracts and the underlying contract ceded to the extent that they share similar risks and other economic characteristics. Allowing a ceding company the ability to recognize a gain upon entering into a reinsurance contract may result in the use of reinsurance contracts for accounting benefits. We believe there may be unintended consequences as a result of this which would represent a step back in reinsurance accounting and should not be allowed.

### **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.**

No. The current model is well understood. A model that excludes the presentation of the nominal cash flows between the two counterparties in an insurance contract from the face of the financial statements does not increase the transparency or decision usefulness of the financial statements.

**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)?**

We believe the premium presentation approach should be used as this model is well understood and provides transparency with respect to the cash flows between the two parties to the insurance contract. In addition, we believe reporting the balance sheet accounts on a gross basis provides much more meaningful information to the users of the financial statements compared to reporting all the balances net.

**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?**

No comment.

**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?**

No. The existing disclosures in GAAP, combined with the requirements of the Securities and Exchange Commission and current industry practice, provide useful and transparent information to the users of financial statements of property and casualty insurers.

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**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.**

We strongly support "e". We strongly urge the FASB to make targeted changes to address specific concerns about current GAAP rather than rather than a comprehensive revision in insurance contract accounting as proposed in the Discussion Paper. Current GAAP is well understood by preparers, users and auditors and provides useful, transparent, consistent and comparable information to the users of the financial statements of short-duration property and casualty insurance companies.