

THE CHUBB CORPORATION

15 Mountain View Road, Warren, New Jersey 07059

December 15, 2010

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

> Re: File Reference No. 1870-100 FASB Discussion Paper, *Preliminary Views on Insurance Contracts*

Dear Technical Director:

The Chubb Corporation is a holding company with subsidiaries principally engaged in the property and casualty (P&C) insurance business. The Chubb Group of Insurance Companies, headquartered in the United States, provides a broad range of P&C insurance products to businesses and individuals around the world. During 2009, the Chubb Group of Insurance Companies produced \$11 billion of net written premiums of which approximately 25% was generated in countries other than the United States. We appreciate the opportunity to comment on the Discussion Paper, *Preliminary Views on Insurance Contracts*. As part of our response, we have attached a copy of our comment letter to the International Accounting Standards Board (IASB) on its Exposure Draft, *Insurance Contracts*.

We support the efforts of the IASB and the Financial Accounting Standards Board (FASB) to improve the accounting for insurance contracts. However, as a P&C insurer we do not believe that the proposed exposure draft would represent an improvement to generally accepted accounting principles currently in use in the United States (U.S. GAAP). In fact, we believe that the model as proposed in the exposure draft would result in financial statements of P&C insurers that are less relevant, reliable and transparent. The principles under U.S. GAAP for P&C insurance have been proven to be effective and financial statements prepared under this basis provide relevant information to regulators, investors and other users of the financial statements in the U.S. as well as globally. We believe that U.S. GAAP should be the starting point for establishing a high quality global standard for P&C insurance contracts.

If the FASB believes that current U.S. GAAP for P&C insurance contracts needs improvement, we recommend that changes be targeted and limited in nature. If the FASB is concerned with a lack of transparency, we would recommend enhancing transparency by adding meaningful supplemental disclosures. Historical loss development information could be an example of additional supplemental information that might be useful to users of our financial statements. Such additional disclosures would allow the users of the financial statements to gain a deeper understanding of a P&C insurer's operating results, financial position and cash flows. We believe that a targeted approach is the most practical way of improving current U.S. GAAP for P&C insurance contracts while preserving the fundamental principles of the current model.

We do not agree with several provisions in the IASB exposure draft and believe the proposal does not adequately recognize the important differences between life insurance contracts and P&C insurance contracts. The exposure draft would result in unwarranted and unnecessary fundamental and comprehensive changes in the accounting for P&C insurance contracts for insurers currently preparing financial statements under U.S. GAAP. Adoption of the proposed accounting model and presentation would result in misleading income volatility, a confusing presentation of insurance contract profitability and the elimination of important performance metrics.

Our positions on the IASB's exposure draft are summarized below:

- There are fundamental differences between life insurance contracts and P&C insurance contracts that the IASB exposure draft does not fully acknowledge. We believe that separate accounting models are needed for short-duration (P&C insurance) and long-duration (life insurance) contracts to address such differences.
- ➤ We do not believe that the current U.S. GAAP model for P&C insurance contracts is broken and in need of significant improvement. The current U.S. GAAP model for P&C insurance contracts is operational, time tested and well understood. Current U.S. GAAP should be the starting point for establishing a high quality global standard for P&C insurance contracts.
- We do not agree with the qualifying condition for the premium allocation model which requires insurance contracts to have a term of approximately one year or less. Contracts with similar economic characteristics should be accounted for in a similar manner. Most P&C insurance contracts have traditionally met the definition of short-duration contracts that exists in current U.S. GAAP. We recommend retaining the notion of short-duration contracts based on the contract attributes rather than an arbitrary contract term.
- We do not agree with the pre-claims liability definition which requires the netting of the pre-claims obligation with insurance receivable and payable balances on the statement of financial position. We recommend that the unearned premium reserve be the pre-claims liability for short-duration contracts.

- We are concerned about the requirements imposed by the proposed onerous contract test for insurance contracts that qualify for the premium allocation method. If such a test is required, we recommend modifying the test to be similar to the premium deficiency test under current U.S. GAAP.
- We recommend that the new guidance recently issued by the FASB to improve the comparability and transparency of deferred policy acquisition costs be included in the final insurance contracts standard.
- We strongly support a measurement approach for post-claims liabilities that reflects economic realities and business models and provides for transparent and easy to understand financial statements. We do not believe it would be practical or appropriate to require issuers of P&C insurance contracts to identify and estimate probability-weighted cash flows as the basis for determining post-claims liabilities. We believe that the post-claims liability should be measured using the best estimate of the nominal expected fulfillment value of claims and related expenses based on entity specific assumptions. We request that the IASB further consider the appropriateness of the well accepted actuarial techniques currently used by actuarial professionals to develop a mean estimate of the expected fulfillment value.
- ➤ Conceptually, we agree that a discount for the time value of money should be reflected in the measurement of P&C insurance claims liabilities if the amount and timing of the underlying cash flows can be reliably estimated. However, this is not the case for most P&C insurance claims liabilities. From a practical standpoint, most P&C insurance liabilities are subject to such significant uncertainty that it is unlikely they would satisfy this criterion. Discounting of P&C insurance post-claims liabilities and the addition of a risk margin would make P&C insurers' income statements unrepresentative of the way P&C insurance companies operate their business. We are opposed to an adjustment for the time value of money and the addition of a risk margin for the uncertainty of future cash flows for P&C insurance contracts. We believe that using the undiscounted mean estimate of the expected fulfillment value remains the most understandable approach to measuring P&C insurance post-claims liabilities.
- ➤ The IASB needs to clarify the proposed recognition criteria for insurance contracts and, in particular, the use of the term "bound," which has a specific meaning in current P&C industry practice.
- ➤ We find the presentation and disclosure framework proposed in the exposure draft to be confusing and burdensome. The basic financial statements should be concise, transparent and able to stand on their own with footnotes that supplement the information in the financial statements. We disagree that a margin presentation in the statement of comprehensive income is an appropriate presentation. For P&C insurance contracts, the customary volume and performance metrics include premiums, claims, acquisition costs and other expenses. These key components of a P&C insurer's operations should be included on the face of the statement of comprehensive income and not as supplemental disclosure in the footnotes.

As a global entity with subsidiaries and operations around the world, we support convergence between the FASB and IASB in accounting for insurance contracts. We prepare financial statements in accordance with U.S. GAAP, U.S. statutory accounting principles and the statutory accounting principles of many countries. International Financial Reporting Standards (IFRS) will replace the statutory accounting principles in many countries in which we conduct our business. If convergence is not ultimately reached, we would be required to maintain multiple accounting systems to comply with U.S. GAAP, U.S. statutory accounting principles and IFRS. This would result in significant operational challenges and will not be cost efficient. The IASB's exposure draft does not represent an improvement over the current U.S. GAAP accounting model for P&C insurance contracts. We urge the FASB to use U.S. GAAP as the starting point for establishing a high quality global standard for P&C insurance contracts and take a targeted approach to making any improvements to this model.

We would be pleased to discuss our comments with the members of the Board or its staff.

Very truly yours,

John J. Kennedy Senior Vice President and Chief Accounting Officer

Attachment



THE CHUBB CORPORATION

15 Mountain View Road, Warren, New Jersey 07059

November 30, 2010

Sir David Tweedie Chairman, International Accounting Standards Board 30 Cannon Street London, EC4M6XH United Kingdom

Re: IASB Exposure Draft – Insurance Contracts

Dear Sir David:

The Chubb Corporation is a holding company with subsidiaries principally engaged in the property and casualty (P&C) insurance business. We appreciate the opportunity to comment on the exposure draft on Insurance Contracts. The Chubb Group of Insurance Companies, headquartered in the United States, provides a broad range of P&C insurance products to businesses and individuals around the world. During 2009, the Chubb Group of Insurance Companies produced \$11 billion of net written premiums of which approximately 25% was generated in countries other than the United States.

We support the efforts of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to improve the accounting for insurance contracts. However, as discussed below, we do not agree with several provisions in the exposure draft and believe the IASB's proposal does not adequately recognize the important differences between life insurance contracts and P&C insurance contracts.

The exposure draft includes alternative views which, depending on how they are ultimately resolved, separately or together could impact the overall approach of the proposed accounting model for insurance contracts. The Boards have different views on several important issues related to insurance contracts. At a minimum, we recommend that the Boards work together to achieve greater consensus and then, if necessary, publish a revised exposure draft. This would allow interested parties the opportunity to review and comment on a proposed accounting standard that could be considered for adoption.

As a global entity with subsidiaries and operations around the world, we support convergence between the FASB and IASB in accounting for insurance contracts. We prepare financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP), U.S. statutory accounting principles and the statutory accounting principles of many countries. International Financial Reporting Standards (IFRS) will replace the statutory accounting principles in many countries in which we conduct our business. If convergence is not ultimately reached, we would be required to maintain multiple accounting systems to comply with U.S. GAAP, U.S. statutory accounting principles and IFRS. This would result in significant operational challenges and will not be cost efficient.

Overall

We believe that there are fundamental differences between life insurance contracts and P&C insurance contracts that the IASB exposure draft does not fully consider. The IASB has taken a positive step to acknowledge these differences by permitting the modified approach for certain short-duration contracts. However, we continue to recommend that the IASB establish separate accounting models for long-duration (e.g., life) and short-duration (e.g., P&C) insurance contracts, due to their different attributes.

Life insurance contracts are typically long-duration contracts that provide coverage and have premium receipt patterns that extend over a lengthy period of time, often many years. P&C insurance contracts are short-duration contracts that provide coverage and contemplate premium receipts over a relatively brief and defined period, often one year or less. Consequently, an important distinguishing characteristic of long-duration contracts is that there is a material time value of money aspect to the premiums received in exchange for risk transfer. By contrast, with short-duration P&C contracts, the difference between the nominal value and the present value of the premiums received by an insurer is relatively small. This could be the basis for a principles-based distinction in the accounting standard.

In addition, the nature of the liabilities and obligations under life insurance contracts and P&C insurance contracts are significantly different. For life insurance contracts, the event being insured against is certain to occur at some point and the amount of future payment obligations is readily determinable at the time of contract inception. For P&C insurance contracts, the possible events being insured against may or may not occur, and the amounts of future payment obligations are not determinable at the time of contract inception. For so-called "long tail" P&C coverages, there is a time value of money aspect to the insurance post-claims liability, but this stems from the time lag between the insured event (which occurs during the still-short coverage period) and the eventual settlement date(s) – which can be much later due to latency of recognition, ongoing costs such as medical care, and/or disputes including litigation regarding the insured amounts. Some of the same reasons for this delay make the settlement amounts highly uncertain, both as to timing and amount. Such P&C cash flows are therefore quite different from those associated with typical life insurance contracts.

A significant driver of business risk for issuers of life insurance contracts is investment return. In fact, many life insurance products explicitly include investment components for policyholders. Unlike life insurance products, earnings of issuers of P&C insurance products are related to fortuitous events. The fundamental business risk for a P&C insurance company is the potential for underwriting gain or loss.

There are several frequently used industry measurements used to evaluate and manage P&C insurance companies, such as the combined loss and expense ratio which measures underwriting results. This ratio is the sum of the ratio of losses and loss expenses to premiums earned (loss ratio) plus the ratio of statutory underwriting expenses to premiums written (expense ratio). When the combined ratio is under 100%, underwriting results are generally considered profitable; when the combined ratio is over 100%, underwriting results are generally considered unprofitable. Investment income is not reflected in the combined ratio. Unlike life insurance, for P&C insurance the underwriting and investment components are evaluated separately. Investment income is also a key metric for P&C insurance companies. The IASB needs to ensure that the accounting model for P&C insurance contracts supports these time tested key performance metrics as this is how P&C insurance companies are managed and evaluated.

As the IASB continues with this project, we urge the Board to reconsider if the proposed model furthers its goal of providing relevant information to users of P&C insurer financial statements. Paragraph IN1 of the exposure draft states the following:

"The IASB has published the exposure draft Insurance Contracts to propose significant improvements to the accounting for insurance contracts. Such improvements are needed urgently. Many users of the financial statements describe insurance accounting today as a "black box" that does not provide them with relevant information about an insurer's financial position and financial performance."

We support developing a high quality global standard for insurance contracts. However, we do not believe that the current U.S. GAAP model for P&C insurance contracts is broken and in need of urgent significant improvement. The principles under U.S. GAAP have been proven to be effective and financial statements prepared under this basis provide relevant information to regulators, investors and other users of the financial statements in the U.S. as well as globally. We do not believe that the model as proposed in the exposure draft would make P&C insurers' financial statements clearer for users. On the contrary, adding additional layers of uncertainty, specifically discounting and a risk margin adjustment, would further complicate the financial statements. We support enhancing the transparency related to the accounting for P&C insurance contracts by adding supplemental disclosures such as loss development tables but by no means should this proven accounting model be set aside due to a lack of understanding on the part of some users. The IASB can address the issue of improving transparency without developing a new insurance accounting model for P&C insurance contracts.

In light of the fundamental differences between P&C insurance contracts and life insurance contracts, the IASB needs to consider an accounting model that addresses the specific issues related to P&C insurance industry. We support a premium allocation model based on the unearned premium reserve model for pre-claims liabilities and a transparent approach to the measurement of post-claims liabilities. We strongly support a principles-based measurement approach that reflects economic realities and business models and provides for transparent and easy to understand financial statements. The measurement model should reflect the significant inherent uncertainties of measuring P&C insurance post-claims liabilities. We believe that post-claims liabilities should be measured using a notional mean/central estimate of the expected fulfillment value (ultimate liability). Although we conceptually understand the IASB's desire to address liability discounting, we do not believe a risk margin adjustment is consistent with the notion of the expected fulfillment value. We have strong reservations about the practical application and overall benefit of each in the measurement of already highly uncertain P&C post-claims liabilities. The inherent subjectivity in and the wide range of possibilities associated with the proposed post-claims liability discounting and risk margin approach are of particular concern.

As a provider of P&C insurance, the balance of our comments will address these types of contracts.

Premium Allocation Model

We support the IASB's view that for short-duration contracts the unearned premium reserve is a reasonable approximation of the present value of the fulfillment cash flows and the residual margin and achieves a similar result at a lower cost (paragraph BC146). However, we have several concerns about the proposed premium allocation model. Contracts with similar economic characteristics should be accounted for in a similar manner. We do not agree with the qualifying condition as prescribed in the exposure draft which requires insurance contracts to have a term of approximately one year or less. Although the large majority of P&C insurance contracts would qualify, certain P&C insurance contracts would not. Such non-qualifying contracts exhibit the same characteristics as the contracts with a term of approximately one year or less; however, some offer longer terms in order to realize cost efficiencies and others, such as surety contracts, have a coverage period that extends for the life of the project that is covered under the contract.

We recommend the IASB adopt a principles-based definition for short-duration contracts based on the contract attributes rather than an arbitrary contract term. Under U.S. GAAP, short-duration contracts are defined as contracts that are intended to cover expected claim costs resulting from insured events that occur during a fixed period of short duration. The insurer also has the ability to nonrenew the contract and to revise the premium (reunderwrite the contract) at the beginning of each contract period to cover future insured events. We believe that the criteria for qualification for the premium allocation method should be based on similar principles. In addition, the IASB may want to clarify that for short-duration contracts, unlike long-duration contracts, the present value of the premium to be received for the coverage period will be relatively similar to the nominal value of such premium.

We believe that the unearned premium reserve represents the insurer's obligation to the insured. As a result, we disagree with the IASB's definition of a preclaims liability. In our opinion, the pre-claims liability of a P&C insurer represents the insurer's stand-ready obligation to pay valid claims for future insured events arising under existing contracts (i.e., unearned premium reserve) or the amount of premium due to the insured if the contract is canceled. The pre-claims liability definition proposed by the IASB requires the netting of the pre-claims obligation with insurance receivable and payable balances. We do not believe the pre-claims liability should include the premiums that will be received or the expenses that will be paid in due course. The unearned premium reserve is the most objective, reliable and transparent measure of the portion of the actual consideration charged for accepting the risk that relates to the remaining coverage period. The IASB's proposed approach also fails to recognize the insurer's obligation to honor and pay a claim regardless of whether or not premiums have been collected. Reporting the premiums receivable and expenses payable separately from the pre-claims liability would allow users of the financial statement to evaluate an entity's ability to collect premiums and pay expenses on such contracts. Importantly, significant systems and process changes would be required in order to comply with the proposed pre-claims liability definition with no apparent benefit. Therefore, we recommend that the IASB use the unearned premium reserve as the preclaims liability for short-duration contracts.

We do not support the accretion of interest on the pre-claims liability for insurance contracts that qualify for the premium allocation method due to the short term nature of these contracts. Accreting interest on a liability that has such a short duration adds complexity and burden and has no meaningful benefit.

We are concerned about the requirements imposed by the proposed onerous contract test for insurance contracts that qualify for the premium allocation method. Any intended relief provided by permitting the premium allocation method as a practical expedient to the full measurement model is nullified if the onerous contract test effectively requires an entity to comply with the full measurement model to perform such test in each reporting period. The IASB is not acknowledging the short term nature of these contracts when considering the practicality of this test. As an insurance entity appropriately establishes its post-claims liabilities, the impact of a contract that is onerous would be recognized. Since premiums are earned over a short period, any liability resulting from an onerous contract would be recognized in a short timeframe.

If the IASB proceeds with requiring an onerous contract test for insurance contracts that qualify for the premium allocation method, we recommend modifying the test to be similar to the premium deficiency test in accordance with U.S. GAAP. A premium deficiency would be recognized if the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs, and other maintenance costs exceed the related unearned premium reserve. We believe that the premium deficiency test should be conducted at least annually, or when a triggering event happens that would indicate a premium deficiency may have occurred.

The FASB has recently considered and adopted new guidance intended to improve the comparability and transparency of deferred policy acquisition costs. The IASB should consider if the amount of deferred policy acquisition costs that would be calculated under that model would be appropriate for inclusion in the final IASB Insurance Contracts guidance.

Post-Claims Measurement

The post-claims liability of a P&C insurer represents the insurer's liability to pay valid claims for insured events that have already occurred. We believe that this liability should be measured using the best estimate of the nominal expected fulfillment value of claims and related expenses based on entity specific assumptions. This approach is consistent with existing U.S. GAAP.

Building Blocks Measurement Approach

Probability-weighted estimate of net cash flows

We agree that the estimate of cash flows should be based on a principle of incorporating all relevant information and making unbiased estimates of the associated expected values. We further agree that if the probability distribution of all possible outcomes were known, then the appropriate expected value would be the mean of that distribution. However, we do not believe it would be practical or appropriate to require that estimated cash flows for P&C insurance contracts be determined by attempting to identify and probability weight all possible scenarios. Due to the almost infinite variety of potential financial outcomes on most individual P&C contracts (including multiple and/or partial loss scenarios), let alone a portfolio of contracts, this is not how such P&C expected values are generally estimated in industry practice. The subjectivity and uncertainty associated with attempting to do so would far exceed the subjectivity and uncertainty associated with developing a mean estimate.

We do not believe the IASB should prescribe the method that must be used by practitioners to estimate cash flows. The IASB rejected an approach that started with existing guidance in the U.S. and other countries which is based on estimating the ultimate cost of settling the claims. We believe that there is a general misunderstanding on how current U.S. GAAP guidance is applied. Most reserving practitioners charged with developing estimates of post-claims liabilities for P&C insurers do not attempt to identify all possible scenarios of uncertain events and assign probability weights to each scenario. Instead, most employ a variety of actuarial methods in order to establish a mean estimate of the expected fulfillment value. We believe this approach of using actuarial methods is consistent with the IASB's principle for estimating cash flows. We request that the IASB further consider the appropriateness of utilizing these well accepted actuarial techniques. We recommend that the techniques utilized to estimate cash flows in accordance with the principle established by the IASB should be developed and determined by actuarial professionals and not prescribed in the accounting literature.

Discounting and Risk Margin

Conceptually, we agree that a discount for the time value of money should be reflected in the measurement of P&C insurance post-claims liabilities if the amount and timing of the underlying cash flows could be reliably estimated. However, this is not the case for most P&C insurance claims liabilities. From a practical standpoint, most P&C insurance post-claims liabilities are subject to such significant uncertainty that it is unlikely they would satisfy this criterion.

The uncertainties associated with most insurance post-claims liabilities are indeed substantial. From a theoretical perspective, an estimate which has been increased by a risk margin is by definition no longer attempting to represent the mean of the potential outcomes; instead it has an upward bias which could be inconsistent with the principle of assessing the expected fulfillment value of the insurance post-claims liabilities.

From a practical perspective, the IASB's proposed risk margin for P&C insurance post-claims liabilities presents significant concerns. First, notwithstanding the specification of the three alternative approaches, the process of selecting a risk margin is inherently subjective. There is simply no way to derive either the appropriate confidence level or the appropriate percentile at which to calculate a tail-value-at-risk or capital requirement: it must be judgmentally determined according to someone's risk appetite. Second, even applied to a hypothetically known probability distribution, the range of outcomes from these three alternative approaches is extremely wide. Third, the underlying "probability distributions" for P&C insurance post-claims liabilities are unknown and extremely hard to estimate. As statisticians and modelers well know, estimating the tail values of probability distributions is much more difficult than estimating central values like the mean. This should be a sobering thought in light of the P&C insurance industry's demonstrable historical difficulty in establishing accurate estimates of even the mean, as evidenced by significant prior period reserve development over time. Finally, in contrast to nominal reserve development, the risk margin is not subject to hindsight testing over time: that is, there is no obvious objective process for looking backward and determining what the "appropriate" risk margin was even at a prior point in time. We believe that these factors will lead to a significant inconsistency of practice with respect to risk margins both across companies and over time, thereby reducing comparability and understanding.

We recognize that there are no easy answers for the inherent theoretical and practical trade-offs raised by discounting and risk margins as applied to P&C insurance post-claims liabilities. We believe, however, that existing U.S. accounting guidance strikes a reasonable and pragmatic compromise among the competing concerns. In particular, P&C insurance post-claims liabilities associated with structured settlements and other situations where both the amount and timing of payment are reliably known may be subject to discounting to their expected present value without risk margin. On the other hand, due to their uncertain amount and/or timing, most P&C insurance postclaims liabilities are expressed at their expected nominal value, thereby including an implicit (but objective and consistent across carriers) risk margin equal to the unquantified discount. This compromise works all the better because the so-called longtail P&C coverages that would deserve the greatest discount for the time value of money are also the ones that would deserve the greatest risk margin. The resulting implicit offset is therefore both conceptually reasonable and practically appealing. And it seems to us that applying an explicit discount and a risk margin to already highly uncertain amounts would only create a false sense of greater accuracy.

The IASB is concerned that insurance accounting is viewed as a black box. Requiring the application of a discount to probability-weighted estimates of cash flows and calculating a risk margin adjustment using one of the three alternative approaches does not make the box any less opaque. We believe that, at a minimum, discounting of P&C insurance post-claims liabilities and the addition of a risk margin would make P&C insurers' income statements more volatile and unrepresentative of the way P&C insurance companies operate their business. Discounting would distort the operating results of the entity and could be misleading to the users of financial information. Therefore, we are opposed to an adjustment for the time value of money and the addition of a risk margin for the uncertainty of future cash flows for P&C insurance contracts. We strongly believe that using the undiscounted mean estimate of the expected fulfillment value remains the most understandable approach to measuring P&C insurance post-claims liabilities.

We continue to advocate for the use of the unearned premium reserve approach discussed above for pre-claims liabilities of short-duration contracts. If the IASB proceeds with the requirement for an adjustment for the time value of money and a risk margin for the uncertainty of future cash flows, for post-claims liabilities we recommend using a method that is both practical and operational. For post-claims liabilities, companies should be permitted to determine the discount for the time value of money at a highly aggregated level, using an expected payout pattern and a risk free rate. We do not agree with the prescription by the IASB of the methods to be used to determine the risk margin. If required to determine a risk margin, we would recommend the use of a single margin that would be locked in at inception (based on the premium charged) and recognized over the coverage and claims handling period. Requiring the recalibration of the margin at every reporting period could create an environment that would allow for earnings management. Calculation of the margin amount, intended to eliminate any gain at the inception of the contract, should also be permitted to occur at a highly aggregated level. A formulaic release of the margin based on the passage of time would be a practical way of releasing the margin.

Recognition

We believe that the IASB needs to clarify the proposed recognition criteria for insurance contracts and, in particular, the use of the term "bound," which has a specific meaning in current P&C industry practice. P&C insurance contracts (including reinsurance contracts) are generally negotiated and agreed to, or bound, in advance of the effective date. However, P&C insurance contracts do not apply until the effective date and are cancelable and can be modified prior to the effective date if circumstances and risks change. The insurer is not exposed to any risk and has no obligations to the insured during the period between when a contract is bound and the beginning of the coverage period that is signified by the effective date. The provision in the proposal that would require P&C insurance contracts to be recognized when they are bound would result in significant operational challenges and costs without any benefit. Currently, the systems of P&C insurers capture financial information as of the effective date of a contract and generally not as of when it was bound. We request that the IASB clarify the requirement in paragraphs 13-15 of the exposure draft to ensure that an insurance contract would not be recognized prior to the insurer being exposed to any risk. As a result, P&C insurance contracts would only be recognized as of their effective dates.

The IASB should provide additional guidance related to the accounting for reinsurance contracts. In particular, the reinsurance measurement model should be the same as the measurement model used for the underlying direct insurance contract. The goal would be to have the accounting treatment for a reinsurance contract be consistent with the accounting treatment for the direct insurance contract that qualifies for the premium allocation method.

Presentation and Disclosures

The IASB notes that the information to be presented in the statement of comprehensive income will help the user of an insurer's financial statements understand the important performance factors. We do not believe that the IASB has accomplished this as it relates to P&C insurance contracts. We find the proposed presentation and disclosure requirements to be confusing and request that the IASB reconsider the proposed presentation and disclosure framework. The basic financial statements should be concise, transparent and be able to stand on their own with footnotes that supplement the information in the financial statements.

We disagree with the IASB that a margin presentation in the statement of comprehensive income is an appropriate presentation. For P&C insurance contracts, the customary volume and performance metrics include premiums, claims, expenses and incremental acquisition costs. We believe that these key components of a P&C insurer's operations should be included on the face of the statement of comprehensive income and not as a supplemental disclosure in the footnotes. As a result, the remainder of our comments related to the statement of comprehensive income will pertain to the model for insurance contracts that qualify for the premium allocation method.

As we previously noted, underwriting performance and investment results are often managed and evaluated separately by P&C insurance enterprises. Underwriting income and combined loss and expense ratios are key performance measures that are widely used and relied upon by investors, analysts and management. Investment income of a P&C insurance company is also a critical performance metric that is utilized by the users of the financial statements. We believe that investment income reported in the financial statements should continue to represent the investment return on financial assets. Under the proposed presentation model, investment income results would be combined with the accretion of interest related to the insurance liabilities or assets. The insurance accounting and reporting model should be consistent with the way P&C insurance companies operate, which would require the disclosure of underwriting components and investment income in the primary financial statements.

The statement of comprehensive income or the related footnotes require the separate presentation of premium revenue, claims and expenses, which we support. We believe that the statement of financial position should separately reflect the total preclaims and post-claims liabilities, a presentation that would be consistent with the component presentation in the statement of comprehensive income. As noted earlier, we do not believe that the pre-claims liability should be reduced by the premiums receivable and expenses payable amounts. In addition, the requirement to include the net asset or liability for each portfolio separately would make the statement of financial position incomprehensible. The IASB should reconsider this proposal and require the portfolio detail information to be included in the footnotes.

The footnote disclosures required under the proposal would be voluminous. The information required to be disclosed goes well beyond the level of information that should be included in financial statements. We believe many insurers would be unable to produce the required disclosures on a timely basis, including being able to provide audit practitioners with sufficient time to audit such disclosures.

In particular, we are concerned with the proposed requirement to disclose measurement uncertainty of the inputs that have a material effect on the measurement of insurance post-claims liabilities. The presentation of such information implies that there is a range around the amount selected and that any number within that range would have been a reasonable substitute for the amount reported. Extended to any number of other estimates within the financial statements, such disclosures weaken the value of financial statements and imply that results in any period could be any amount along a continuum of options.

While we understand that the Board's objective is to improve comparability and understandability of insurance contract liabilities presented and disclosed in the financial statements prepared in accordance with IFRS, we believe that the proposed disclosure requirements advance a flawed notion of providing alternative measurement information within the financial statements. Disclosing alternative amounts may suggest that the amounts reported may represent an amount selected from among a range of otherwise acceptable amounts and do not represent the most appropriate amounts.

A significant amount of time and resources would be required to produce the proposed measurement uncertainty disclosures. The cost of compliance would exceed the benefit to users. Actuarial methods commonly used in estimating insurance post-claims liabilities are based on multiple techniques and a significant number of inputs. It would be difficult and time consuming to determine reasonable possible alternative inputs as a result of the numerous correlations between changes in significant inputs and the iterative impact they may cause. Correlations are not static and the more inputs there are, the more complicated the calculations and disclosures become. Therefore, we would recommend eliminating these disclosures from the final guidance.

Transition and Effective Date

We do not support the proposed transition requirements to derecognize the residual margin on insurance liabilities and deferred acquisition costs. The proposed transition model would distort performance metrics and comparability for a period subsequent to adoption. For P&C insurance contracts the current unearned premium reserves generally reflect the pre-claims obligation in accordance with the premium allocation model. At transition, we would recommend permitting the unearned premium reserve to be earned prospectively. We believe that this would be the most practical and operational approach and it would produce more comparable results than derecognizing the residual margin. This methodology would rightfully allow entities to recognize revenues on policies written prior to adoption of the new guidance and produce comparable results between years and entities. We also believe that deferred acquisition costs and post-claims liabilities should be measured using the new guidance and any changes in the measurement should be reflected in the beginning retained earnings of the earliest year presented.

The Board must ensure that insurers have sufficient time to adopt a new accounting model for insurance contracts. In addition to this exposure draft, the IASB needs to consider that insurance entities will also be affected by many of the currently proposed and recently issued standards. The changes proposed by the exposure draft would fundamentally change the accounting and reporting for insurance contracts. Insurers will need substantial time to develop and test the systems and the processes needed to prepare the required information. The IASB needs to consider all these factors when determining an appropriate effective date.

Field Testing

We recommend that the IASB and the FASB work with segments of the insurance industry to field test the approach they decide to pursue before a final standard is issued. Field testing would highlight the practical and operational issues that insurers would face in implementing various aspects of the proposal and would ensure that the proposed guidance results in relevant, reliable and decision useful information for financial statement users. We believe that the exposure draft will need to be reexposed since significant concepts would need to be clarified or modified.

We are aware of the self-imposed timeframe of the IASB to conclude on certain projects. We strongly support quality accounting standards and encourage the IASB and the FASB to issue a converged standard that appropriately addresses the different business models for life insurance contracts and P&C insurance contracts. This should not occur until the appropriate due diligence and field testing are completed. We do not believe that the insurance contracts guidance, as proposed, would provide investors with the most relevant and reliable information. We urge the IASB not to sacrifice quality for the sake of meeting this self-imposed deadline.

We would be pleased to discuss our comments with the members of the Board or its staff.

Very truly yours,

John J. Kennedy Senior Vice President and Chief Accounting Officer