



June 19, 2009

Mr. Robert H. Herz  
Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856

RE: File Reference No. 1660-100

Dear Mr. Herz:

The Group of North American Insurance Enterprises (“GNAIE”) appreciates the opportunity to offer comments on *Preliminary Views on Revenue Recognition in Contracts with Customers* (“the “Discussion Paper”) which is a joint project of the Financial Accounting Standards Board (“FASB”) and the International Accounting Standards Board (“IASB”). GNAIE supports the FASB’s and IASB’s efforts to improve and clarify the principles for recognizing revenue. We believe that the Discussion Paper (“DP”) could result in a clearer, more concise and consistent principles-based approach to recognizing revenue across industries than the models that currently exist under U.S. GAAP or IFRS.

Several of the concepts proposed in the DP provide a useful broad based framework for recognizing revenue under insurance contracts such as contract based revenue, measurement principles and the identification and satisfaction of performance obligations; and establishes an appropriate starting point for the insurance contracts model. We describe in our comments several situations that are specific to insurance for which we believe clarification is needed to apply the concepts in the revenue recognition paper to insurance contracts. Separately, the insurance contracts project could appropriately clarify and address the specific situations highlighted in our comments.

If the members of the staff or boards desire further discussion of any points contained in this letter, we would be willing to meet at your convenience.

Sincerely yours,

A handwritten signature in black ink that reads "Jerry de St. Paer". The signature is written in a cursive, flowing style.

Jerry de St. Paer  
Executive Chair, GNAIE

JdSP:PS:c11

Jerry M. de St. Paer  
Executive Chair

Douglas Wm. Barnert  
Executive Director

**Group of North American Insurance Enterprises**  
40 Exchange Place, Suite 1707  
New York, NY 10005  
UNITED STATES

++1-212-480-0808  
info@gnaie.net  
www.gnaie.net

## Questions on Chapter 2

### Question 1

**Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles**

We agree that revenue should be recognized based on changes in contract assets and liabilities, which are the fundamental components of an entity's financial statements; as long as the asset and liability measurements are appropriately calibrated to the performance obligations expected to be satisfied over the life of a contract, particularly for contracts providing services. For insurance contracts, we believe that the performance obligation is the risk protection service provided to the customer and that the performance obligation should be allocated among the reporting periods within the insurance coverage period. These concepts are further discussed in responses to questions in Chapters 4 and 5.

### Question 2

**Are there types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think would be more useful in those examples.**

We believe that broadly, the principles proposed would be appropriate for insurance contracts, and with certain modifications necessary would result in the reporting of decision useful information with respect to insurance contract revenues. Premium revenue from insurance contracts should be recognized over the period of insurance protection provided. For instance, either within the revenue recognition standard or separately within the insurance contracts standard, it should be recognized in some fashion that the premiums that insurers charge to their customers are expected to enable them to recover costs of acquiring the contracts and realize a profit over the life of the contract. The insurer should not be required by the standards to recognize an artificial loss at inception due to such acquisition costs, even though the insurer has substantial experience on which to base expectations that the contracts will be profitable.

### Question 3

**Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition?**

While we agree conceptually with the direction the boards have taken regarding their definition of a contract, some specific aspects of the definition may be difficult to apply. The examples utilized in the standard represent fairly straightforward transactions; however, the issues associated with more complex contracts such as insurance contracts should be addressed either in the revenue recognition standard or the insurance contracts standard. For instance, there have been discussions by the IASB and the industry around the boundaries of the insurance contract in relation to policyholder behavior and future premiums. This issue is important for determining when an existing contract has ended and a new contract begins for determining the amount of future cash flows that should be considered in a particular contract. Our view is that the boundary of a contract is at the point at which it

can be re-priced without restrictions by the insurer and the insurer has the ability to both reassess the risk profiles and change the price for the individual without contractual constraint. Once the contract boundary has been established then the measurement of the insurance liability should take into account the expected cash in-flows to be received within the contract's term (boundary). The IASB has been discussing various approaches to continuation payments and cancellation options inherent in insurance contracts as it relates to boundaries of a contract. We believe that the proposed approach of looking through the option by treating cash flows subject to continuation payments and cancellation options as part of the existing contract is appropriate.

While we understand the proposed definition of a contract in the revenue recognition paper is intentionally and sufficiently broad so that it can apply to all industries, we see a need for more clarity on the boundary questions as it will have significant accounting and financial statement implications for insurance contracts particularly life contracts.

### Questions on Chapter 3

#### Question 4

**Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.**

We believe this definition is appropriate.

#### Question 5

**Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?**

We agree as long as the promised assets transferred to the customer in an insurance contract are deemed to be the service of providing coverage. We do not believe that an entity should separate the performance obligations in a contract on the basis of when an entity might transfer cash to the customer (claim payments). The performance obligations in insurance contracts are satisfied continuously and simultaneously over the coverage period. We view this insurance coverage (or risk protection period) as being the sole performance obligation. The claim settlement period should be disregarded for revenue recognition purposes since claims are all recorded and expensed entirely within the coverage period (with estimates recorded for remaining payments and incurred claims at the end of the period). It should therefore be required that all revenue associated with such expenses be recorded over the same period.

#### Question 6

**Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?**

We do not believe that return of consideration or other types of refunds as it relates to insurance contracts are a significant concern for the insurance industry. Further, we do not believe policy surrenders to be a refund of the customer's consideration. Given the minimal impact, we have no further comment.

#### Question 7

**Do you think that sales incentives (eg discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?**

If specific requirements for the customer to fulfill in order to earn the sales incentive (such as bonus interest or a persistency bonus) are provided within the same contract as the original transaction, contingent payments earned by the customer are performance obligations of the original contract and revenue should be recognized to cover the expected cost of those benefits. If, however, a separate contract resulted from the opportunity to realize the benefits of the sales incentive, then the sales incentive performance obligation is not related to the current contract but rather a separate contract.

### Questions on Chapter 4

#### Question 8

**Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.**

We agree an entity satisfies a performance obligation when the customer receives the promised service or controls the promised good; therefore revenue should be recognized on this basis. Furthermore, we believe this basis of revenue recognition can be applicable and appropriate for insurance contracts. Risk protection services are provided by an insurer continuously over the coverage period and begin to be used by the customer immediately. The insurer's obligation to provide coverage will result in compensation to the policyholder if an insured loss occurs during the coverage period. Loss adjustment activities may take place to confirm the amount of and provide payment for the loss subsequent to the loss occurrence date, however, control of an asset (the right to receive compensation) is effectively transferred and is recognizable by the customer as of the loss date. The policyholder's right to receive such compensation is established when the insured loss occurs. Revenue recognition over the coverage period of an insurance contract is appropriate whether or not an insured event occurs since the services are being provided over the term of the coverage period.

#### Question 9

**The boards propose that an entity should recognize revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so please provide examples.**

For insurance contracts, we agree revenue should be recognized during the period over which the performance obligations are being satisfied with the understanding that satisfaction of the performance obligations are recognized over the coverage period (i.e., the period over which risk protection is provided) rather than over the entire claim settlement period.

## Questions on Chapter 5

### Question 10

**In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.**

**(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?**

Performance obligations depict an entity's present obligation arising from its contractual promise to transfer goods and services to a customer. For insurance companies, the performance obligation represents the insurance coverage (or risk protection service) provided to the customer. The performance obligation is allocated to each reporting period within the coverage period. We agree that the starting point for measuring and calibrating such performance obligations should be the premium at inception since the premium established on Day 1 is the most observable and verifiable price available at the time the contract is signed. However, the premium includes an element related to acquisition costs incurred by the insurance company which is passed on to the policyholder. Since those costs can be significant on Day 1, will be recovered over the often long duration of the insurance contract, and do not relate to any "performance obligation" the insurance company would have to perform on behalf of the customer, those costs should not be considered part of the future performance obligation. Therefore, rather than measuring the value of the performance obligations and calibrating to the gross premium, the performance obligations should be calibrated to the premium net of relevant acquisition costs included in the initial premium. The relevant acquisition costs should be those costs that vary with and are primarily related to the acquisition of the contract or at least include those costs that are incremental to the transaction.

Whether the portion of the consideration received to cover acquisition costs is considered revenue or income, it should be recognized when the acquisition costs are incurred and not over the performance obligation period.

**(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?**

For Life insurance contracts, we believe that if *at inception*, the expected costs of satisfying the performance obligation exceeds the carrying amount, it should be deemed onerous *at inception*. It should be noted, however, that although the DP does not address time value of money, an inappropriately low discount rate such as a risk free rate may make certain long duration contracts with fixed cash flows *appear* to be onerous at inception when they are not. However, on Day 2, we believe that the risk margin should be held consistent with the pattern established at the time the contract is issued, to release margins as the insurer is released from risk over the life of the contract; but the expected claim costs should be evaluated every reporting period. As such, since the expected claim costs are continuously evaluated, the performance obligations would properly reflect any losses or gains during the period. Therefore, no onerous tests are required. This would also eliminate the one way effects of only recording losses in adverse periods and no gains in favorable periods. There should be parameters around the timing and extent of unlocking in order to avoid any significant accounting volatility that does not represent the underlying economics of the contract. The parameters relating to unlocking financial variables should be consistent with the remeasurement of the invested assets which will be based on the final results of the financial instruments project that is currently being deliberated by the FASB and IASB.

For P&C insurance contracts, it would be helpful to clarify that the proposed measurement model in the revenue recognition DP should apply to the pre-claim liability in the insurance contracts DP and not to the post-claim liability. We believe that the pre-claim liability should be measured at the transaction price at inception (unless it is onerous at the inception date) and only be remeasured if the contract becomes onerous during the coverage period. The post-claims liability, which should not affect revenue recognition, is continuously adjusted for favorable or unfavorable loss development.

**(c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.**

First as discussed in (a), although acquisition costs are not a performance obligation, it is necessary to measure those costs and exclude those costs from the measurement of the performance obligations in order to produce a faithful economic representation of the transaction. Second, we strongly believe the performance obligations to the customers are to provide risk protection only. In contrast, ancillary activities such as investment management and claim adjustment services occur as a result of the insurance contract and are in part performed for the benefit of the insurer to maximize funds available to pay contractual claims/benefits and ensure that claims are paid pursuant to the terms of the contract. Accordingly, we do not believe these ancillary activities represent separate performance obligations for purposes of determining revenue recognition over the risk protection period.

It is important to limit recognition of the performance obligations in an insurance contract to the insurance coverage period. To the extent that the claims paying period extends beyond the coverage period, the resulting claim liability should be addressed by an insurance contracts standard separate from any revenue recognition standard. The claims paying activity should not be considered a performance obligation, but rather the settlement of the obligation already incurred during the coverage period. Therefore, insurance products that have exposure to asbestos or pollution losses providing one year of coverage, but for which the claims incurred during that year may be paid out over 50 years, the revenue should be recognized over the one year coverage period. To the extent a claim liability exists at the end of the coverage period, the only adjustments to the income statement subsequent to the contract period would be refinements to the value of that liability. As such, we believe those refinements cannot be linked to the revenue allocated over the coverage period. The insurer establishes a liability for claims that are reported but not yet settled, and a liability for claims that have been incurred but not yet reported (which may be a very significant liability for several decades for some coverages, such as the asbestos coverage cited above). The insurer will recognize gains (or losses) after the end of the coverage period to the extent that its estimated liabilities at the end of the coverage period overstate (or understate) the value of claims that actually emerge over time.

**(d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.**

We do not believe there should be other measurement approaches utilized for revenue recognition of insurance contracts.

## Question 11

**The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.**

**(a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?**

We do not agree. Including such costs increases the value of the performance obligations and generates losses upon the sale of profitable contracts. This causes the financial statements, particularly the income statement, to provide an unfaithful representation of the economics of the transaction. This distortion would be particularly severe for long duration contracts. The measurement of performance obligations should be based on the transaction price net of the costs that vary with and are primarily related to the inception of the contract. (i.e., the transaction component related to the acquisition costs should be separate from the performance obligations as discussed in Question 10(a)).

**(b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.**

As mentioned, acquisition costs for insurance companies can be significant and are typically recovered through their inclusion in initial premiums. They should not be immediately expensed without any offsetting income since reported results on such a basis would reflect losses upon inception of contracts that are reasonably expected to be profitable and inflate income in future periods. As such the income would not be a faithful representation of the economics of the transaction. Losses would be recognized in periods when profitable sales increase, and profits could be recognized in periods when profitable sales are declining. We do not believe such accounting provides decision useful information to users of financial statements. It is not representationally faithful, and is misleading. Particularly for long duration contracts with significant upfront expenses that are recovered over multiple future periods, we believe that appropriate accounting for the expense would be to reduce the value of the performance obligations and the initial liability by the amount of relevant acquisition costs, generating either revenue or some other form of income. Alternatively, deferring the acquisition costs as a separate asset could be another viable option.

## Question 12

**Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?**

We would agree only if the obligations are clearly separable and the values are reliably determinable. As mentioned in Question 10(c), there are investment and claim services embedded in the performance obligations of insurance contracts. These elements cannot be broken out reliably as the contract is not priced explicitly for these items. Breaking out and tracking such costs each reporting period would not only be a significant administrative burden, the information would not be meaningful or useful to the financial statement user.

Claim handling activities should not be viewed as a separate performance obligation delivered to the insured. In the vast majority of cases, policyholders do not seek to buy claim handling services separate from risk protection and do not view claim handling as a separate benefit. In some cases, large commercial insurance policyholders purchase claim handling services separately in which case they would be priced and accounted for as separate contracts. But the mere fact that some policyholders elect to bifurcate the claim handling from the risk should not result in claim handling activities being identified as a separate performance obligation for insurance contracts as a whole. The DP states that if various elements of performance under the contract are delivered "at the same time", then the elements do not need to be accounted for separately. In the case of an insurance contract, the accounting for revenue from providing risk protection should not vary depending on how long it takes for a claim to be reported and settled. Many claims are reported by the claimant during the coverage period (i.e. "at the same time" as coverage is provided) and continue to be settled over a number of years and it does not make sense to bifurcate revenue on the basis that some claims are reported during the coverage period and others are not or that some take a short time to settle and others take a longer time to settle.

### Question 13

**Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?**

We do not think this should apply to insurance contracts. See response to question 12.

### **Additional Comments – Time Value of Money:**

Although the Discussion Paper does not address time value of money, we believe that some comment on the topic is appropriate. We believe that the discount rate used for measuring contract assets and contract liabilities should reflect the economic reality of the transaction. Such a rate would be above the risk free rate, but would not be a rate that incorporates an exit value notion of non-performance risk.

We agree with the statement in the agenda paper for the March IASB meeting that a risk free rate would not be an appropriate discount rate because it "would not reflect the parties to the transaction being accounted for," and thus, a contract asset or liability whose cash flows were discounted at the risk free rate "would not be very useful to a user. It is clear that customers generally require, and entities, including insurance entities, are generally willing to pay, interest rates above risk free rates on insurance contracts. Discounting at risk free rates would make some profitable contracts appear to be onerous, which would not be representationally faithful.

We also agree with the statement in the agenda paper that, with respect to reflecting credit characteristics of a liability, "the staff is wary of making this issue too complex." We believe that an exit value notion, consistent with FAS 157, of non-performance risk in order to reflect time value of money is more complex than necessary. This is particularly the case due to the fact that many contracts that would be covered by the Revenue Recognition standard do not have an exit value. Furthermore, in some economic environments, incorporating an exit value notion of non-performance risk can distort the contract asset or liability value particularly in instances when the intention of the issuer or investor is to hold the instrument rather than when the intention is to actively buy or sell it. Such distortion causes significant accounting volatility and would not be representationally faithful.