



October 16, 2009

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

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London EC4M 6XH
United Kingdom

RE: Insurance Contracts Project Status and Direction

Dear Chairmen:

At its September meeting, the IASB narrowly voted in favor of measurement for insurance contracts based on the approach being developed in the project to amend IAS 37, but modified to exclude day one gains. The FASB reached a different tentative conclusion, which is described on its web site as a current fulfillment value without an explicit risk margin. A significant minority of the IASB members also supported such an approach, and the IASB stated that its exposure draft will explain both approaches. The IASB plans to issue its exposure draft around the end of 2009; but it is not clear to us whether the FASB will issue its own draft or join with the IASB in a single exposure draft. The decision(s) on measurement approach is (are) the foundation(s) on which many of the other key provisions in the exposure draft(s) will be based.

In this letter, we describe what we see as needs and opportunities for the Boards to clarify the measurement approach(es); and in so doing, perhaps narrow the differences between the two Boards and among IASB members. We begin by summarizing our key positions on accounting for insurance contracts. We presented these positions to both Boards in the past; but we think it is useful to summarize them here, as the Boards move to draft and finalize their exposure document(s).

Summary of GNAIE Positions

The measurement approach that GNAIE supports is “contract fulfillment value”, which has many of the elements of “current fulfillment value”. Fulfillment values approaches are based on settlement with the policyholder according to the contract terms. Such approaches recognize that insurance liabilities typically cannot be transferred (due to business and legal reasons), and that insurers typically cannot and do not make payments to policyholders (or to other parties) to be relieved of their contractual obligations. Therefore, transfer-based measurement approaches (such as IAS 37 or current exit value) must be derived from speculative and non-observable assumptions. Furthermore, it is not clear how some aspects of measurement based on the IASB’s project to amend IAS 37 would be applied to insurance (e.g., service obligations and margins), because that project is unfinished and

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only a narrow majority of IASB members expressed support for applying such an approach to insurance contracts.

GNAIE continues to advocate different measurement models for life and non-life insurance, because of fundamental differences in the contract and coverage arrangements. The FASB is considering two separate models. The IASB has tentatively agreed that an unearned premium reserve (“UPR”) should be used as a proxy measure for short duration insurance liabilities, such as pre-claim liabilities for non-life insurance contracts.

GNAIE believes that both the life and non-life models should provide for no gain at inception, but that losses should be recognized at inception for contracts that are determined to be onerous. Both Boards have tentatively agreed with these positions. For contracts that are not onerous, the flow of premiums will provide for recovery of costs that are incurred in acquiring insurance contracts if those contracts are appropriately priced and underwritten. If these contracts are not onerous, the insurer should not be forced to recognize a loss at inception as a result of acquisition costs. We are very concerned that the FASB’s tentative decisions on costs and revenue to be recognized at inception may result in a reported loss that would be inconsistent with economic expectations. We do agree with the tentative conclusion that both Boards reached that the contract “boundary” should be limited by contract terms such as when the insurer is able to re-price and/or re-underwrite the contract risks.

Life Insurance

GNAIE agrees that three building blocks (expected cash flows, discounted, with margins) are appropriate as a basis of measuring life insurance liabilities.

Expected cash flows. All cash flows that are expected within the contract “boundary” should be considered, including future premiums and discretionary participation features on a probability weighted basis. We understand that both Boards are planning to discuss treatment of discretionary participation features, which are essential elements of many life insurance contract types (including participating whole life and universal life insurance). Whatever approach is used for recognizing acquisition costs should reflect recoverability of such costs from expected premiums, again on a probability weighted basis. Estimates of cash flows should be updated at each reporting date to reflect all relevant information that is then available.

Discount rate. According to the IASB Update for the September 2009 meeting, the Board concluded that the discount rate for an insurance liability should conceptually adjust estimated future cash flows for the time value of money in a way that captures the characteristics of that liability rather than using a discount rate based on expected returns on actual assets backing those liabilities; and the Board further concluded that the accounting standard should not give detailed guidance on how to determine the discount rate. We agree that the accounting standard should not include such detailed guidance; but we are not sure whether the Board’s direction will allow for discount rates that reflect the necessary effects that asset cash flows have on liability cash flows for many insurance products (including participating whole life and universal life insurance). Without considering such effects in the discount rates, there can be mismatches in the treatment of assets and liabilities, and potentially large reported day one losses on contracts that are reasonably expected to be profitable. These concerns potentially could be addressed with discount rates that are adjusted to reflect characteristics of the liabilities, such as limited liquidity.

Margins. GNAIE supports a measurement approach with a single margin. While it is possible to define calculations of margin components that could be called risk margins or service margins, we do not believe that such sub-divisions provide decision-useful information. The single margin in the “current fulfillment measurement” that the Boards discussed has been characterized as a “composite margin”. It could also be thought of as the “risk margin” that is calibrated at inception to be consistent with the tentative conclusion of both Boards in favor of no gain at issue. Clarification would probably be needed for recalibration of any margin or margin component after issue, because there is typically limited, if any, new information on which to base such recalibration.

Non-Life Insurance

The positions described above regarding a UPR for short duration liabilities and regarding recognition of losses (but not gains) at inception are fundamental elements of the measurement model that GNAIE recommends for non-life insurance. The other fundamental elements are:

- 1) The UPR is reduced to zero by the end of coverage period; but the claim liability grows as claims are incurred. The claim liability includes a reserve for incurred but unreported claims.
- 2) The claim liability is based on a best estimate of ultimate losses. It is not discounted and is not based on probability weighting of expected cash flows. It is developed from actual information on individual claims, which we believe is more relevant and decision-useful than attempting to probability-weight different claims scenarios, either on a portfolio or individual claim basis. The claim liability is re-measured at least at each reporting date, and perhaps more frequently.
- 3) There are no explicit margins in the claim reserves, and therefore no separate identification of margin components (e.g., for risk or service). While the claim liability is re-measured based on new information, there is no independent, reliable, or otherwise verifiable basis on which margins can be recalibrated. Providing information on margins and changes in margins would be based on theoretical calculations, and would imply that this information has meaning in spite of the speculative and artificial ways in which it is calculated.

Underwriting income is the key performance metric for non-life insurers world wide. Decision-usefulness of financial information about non-life insurance would be reduced by an accounting standard that tends to obscure this key metric.

Measurement Approaches/Margins

The key issues for margins, where there are explicit margins, are:

- 1) Whether the margin is divided into pieces (e.g., one composite margin in the fulfillment value approach; an explicit risk margin, perhaps service margin(s), and a residual margin in the approach based on IAS 37);
- 2) The basis for releasing the margin parts (over what time and at what rate); and
- 3) Re-measurement (whether to re-measure, and how often).

The IAS 37 measurement approach would probably require re-measurement of margins. Such re-measurement may or may not be included in fulfillment value measurement approaches. Some basis could be established for how to re-measure the margins in the absence of a market observable basis. One possibility would be to express the margin at inception (the composite margin for fulfillment value, the components of the total margin for the IAS 37 measurement approach) relative to one or



more major assumptions or inputs to the liability valuation (e.g., mortality and persistency rates for life insurance; expenses and persistency for service margins, if there are such explicit margins), and adjust the margin (or margin components) as these assumptions are updated over the life of the contract.

The Need for Field Testing

Field testing could be extremely beneficial in assessing the practicality of approaches that the Boards are considering in the insurance contracts project, as well as the costs of providing information in relationship to the benefits and decision-usefulness of the information. We are particularly concerned about meaning that may be attributed to information that is based on theoretical calculations that cannot be confirmed by observed market information. Even though meaningful field testing may not be completed prior to the start of the comment period(s) for the document(s) that the Boards will be exposing, we believe that testing of approaches to margins, discount rates, and acquisition costs can be extremely helpful to the Boards and to constituents who will be commenting on the exposure documents.

Sincerely,

A handwritten signature in black ink that reads "Kevin Spataro". The signature is written in a cursive, slightly slanted style.

Kevin Spataro
Chairman, GNAIE Accounting Convergence Committee

KAS:KK:WES:cll