

September 15, 2006

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

The September IASB Meeting

Dear Sir David

At the September meeting of the IASB we understand that there will be discussion of topics related to Phase II of the Insurance Contracts Project. The Group of North American Insurance Enterprises (GNAIE) and the four Japanese Life Insurers offer the comments below on the issues to be discussed, copied from the agenda in *Italics* below. These comments are not intended to be a final and complete discussion of the issues, but are a summary based on our continuing discussions with users, preparers and other interested groups. We want to again express our appreciation for the opportunity to give a joint presentation, with the CFO Forum, at the September IASB meeting. We look forward to sharing our views on these important topics with the IASB.

Reporting changes in insurance liabilities. *The Board will consider whether it should specify how insurers should disaggregate changes in insurance liabilities.*

The issues of presentation should be dealt with after due consideration of recognition and measurement for insurance contracts. We do support the disclosure of performance and value-based measurements as supplementary information. We would point out, however, that Embedded Value and Gains by Source are only two methods for analyzing financial information for insurers. Other methods exist and we question whether the Board should single out any one method as a requirement.

We are also concerned that required a “sources of earnings” presentation for all contracts might present significant practical issues for preparers. In particular, there is no generally accepted way to derive the various items in such a presentation for participating contracts since dividends are not separated between the part arising from interest, the part from mortality and other assumptions.

More generally, the allocation of earnings by source is often distorted by policy provisions and may not give a true reflection of what has happened. For instance, a policy with a large front-end load may show a larger expense gain and smaller interest gain than a policy with a larger back-end load. This kind of analysis typically requires considerable explanation and therefore is more suited to presentation in an MD&A rather than on the face of the income statement.

Investment contracts. *The Board will review a comparison of its tentative conclusion for insurance contracts with existing requirements in IAS 39 Financial Instruments: Recognition and Measurement and IAS 18 Revenue and assess the implications of any differences.*

We support the Staff's recommendation that the Discussion Paper should document and seek feedback on differences in accounting for insurance and investment contracts. We also encourage a comparison to the revenue recognition and fair value measurement projects.

A portfolio basis for measurement. *The Board will consider whether insurance contracts should be measured on a portfolio basis and, if so, how the portfolio should be defined.*

One of our principles is that measurement should be based on a portfolio of exposures. Actuarial methodologies only apply when the law of large numbers can be invoked. Accordingly, measuring liabilities at the individual contract level is not appropriate unless the contract itself is a portfolio of exposures. (This can happen in certain group situations.) A portfolio is a group of contracts that are managed together when assessing risk. A portfolio may include one or many contracts but typically will comprise many contracts reflecting the pooling of risks inherent in the insurance business model. Portfolios should be defined and measured the way a company manages its business and on a consistent basis in successive reporting periods. Indicators that a group of policies are managed together may include: consistent pricing or underwriting strategy, internal management reporting bases, capital management, and/or reinsurance strategy.

There is a difference between applying portfolio metrics to individual contracts (still a portfolio approach) and an individual contract level unit of account, which is establishing a liability separately for each contract. Insurance contracts are underwritten at issuance and subsequently insurers do not maintain liability information for individual contracts. In general, information represented as the liability for an individual contract would be merely an allocation of the total liability for a portfolio of contracts, including allocation of components (e.g. risk margins) that are clearly based on characteristics of the entire portfolio. We therefore would agree with the Staff's conclusion that the expected cash flows from a portfolio equal the sum of the expected cash flows of the individual contracts.

We also agree that risk margins must be based on portfolios. On the other hand, we do think that using a portfolio measurement basis makes use of certain assumptions, such as those involving policyholder behavior, much easier to understand and accept.

Unbundling. *In April, the Board concluded that insurers need not unbundle deposit and service components of insurance contracts for the purpose of recognition and measurement. At this meeting, the Board will discuss whether unbundling should be prohibited in some or all cases. (On a related topic, the Board decided in July that the discussion paper will consider whether an insurer should unbundle deposit and insurance components for the purpose of presenting premiums and claims, but will not express a tentative conclusion.)*

While there are several issues related to unbundling, the Board's discussion on September 20 is scheduled to focus on whether unbundling should be prohibited in some or all cases. We do not object to the Staff's recommendation that unbundling should not be specifically prohibited; but we also believe that unbundling is generally not necessary for reliable and relevant presentation of information about insurance contracts. Insurance policies should only be unbundled in the event that the separation would result in material differences in the overall value of the contract and either:

- a. The deposit and insurance components of the contract are separately priced and separately managed by the insurer; or
- b. Separate measurement of a deposit component is necessary to recognize rights and obligations of the insurer and the policyholder.

In general, insurers price insurance policies on an integrated basis. It would be extremely rare that an insurer prices and manages each of these components separately or that the separate measurement would be materially different. In most situations unbundling would only add to the complexity of the calculations and presentations without adding to a user's understanding of the results.

Policyholder participation rights. *The Board concluded tentatively in March that an insurer should recognize a liability relating to expected dividends to participating policyholders if the insurer has an enforceable obligation. At this meeting, Board will discuss how an insurer should present policyholder participation rights if an insurer has no enforceable obligation.*

Liabilities for participating contracts must include provisions for all expected payouts of policyholder dividends. The idea of including provisions for future dividends in equity, even if they are distinguished from equity attributable to shareholders, will lead to huge gains being recognized at inception, which is irrational and misleading. In addition, such treatment is inconsistent with the Board's tentative decision on the measurement attribute. While we do not support that decision entirely, a true "exit value" would include the amount to be distributed to policyholders as future dividends because, in the case where participating contracts are to be transferred to another insurer, the transferee will require that all expected cash flows (including policyholder dividends) be included in the calculation of a transfer price. In addition, payment of policyholder dividends will affect other cash flows that would be considered in the "exit value", because such payments have a significant affect on policy persistency.

We disagree with the notion of a legal or equivalent compulsion as the most appropriate test to determine whether an insurer should recognize a liability relating to expected dividends to participating policyholders. Although the distribution to policyholders may not occur until some time in the future, a constructive obligation to do so clearly exists. We suggest a determination based on such a criterion.

Universal life contracts. *In May the Board had a preliminary discussion of universal life contracts. At this meeting, the Board will:*

- o *continue its discussion of whether an insurer should recognize the policyholder's account balance separately from the other components of the contract.*
- o *consider the treatment of policyholder premiums exceeding the premiums that the policyholder must pay to maintain guaranteed insurability?*

Universal life contracts should be treated like all other life insurance contracts. The measurement of insurance contract liabilities should be equal to the present value of all future expected benefits and expenses, without exception, less the present value of all future expected gross premiums, using market or entity-specific assumptions. The second paper from the IAA/ACLI task force dealt with this issue in some depth and we agree with the Staff that it would be good additional background reading on this subject.

From a technical perspective, we agree that for the example shown that it doesn't matter how the liability is measured, however, we think that for a policy where there are surrender charges or where the discount rate and the crediting rate are not identical, there may well be a difference. For this reason, we support using the discounted value of future cash flows at the average earned rate in order to determine the liability measurement.

It is also relevant to note that for universal life contracts, the Staff recommends that estimates of crediting rates in each scenario should reflect what the insurer actually expects to do in that scenario, rather than assume that the insurer pays the absolute minimum that can be contractually required; because the Staff believes that a measurement based solely on the contractually guaranteed minimum crediting rate is unlikely to provide useful information for users. We agree with this reasoning with respect to universal life contracts; and we strongly believe that it also applies to other participation rights and features of insurance contracts.

On other papers, we note that the Board will be discussing revenue recognition again at this week's meeting. With respect to the Board's proposals, we support the further investigation of what is referred to as Approach B for the reasons the Staff indicates.

We hope that these brief comments will be of help to the Board in its upcoming discussions. If you or any Board Member would like clarification of our position on these issues, we would be glad to provide it.

Group of North American Insurance Enterprises

Richard J. Carbone, Chair, CFO
Prudential Financial, Inc.

William G. Gasdaska, CFO
General Reinsurance Corporation

Jerry M. de St. Paer, Vice Chair, CFO
XL Capital, Ltd.

Victor C. Moses, CFO
Genworth Financial, Inc.

Philip Bancroft, CFO
ACE Ltd.

Robert Price, Controller
The Hartford

Steven J. Bensinger, CFO
AIG, Inc.

Joseph J. Prochaska, Jr., CAO
Metropolitan Life Insurance Company

Danny L. Hale, CFO
The Allstate Corporation

Michael E. Sproule, CFO
New York Life Insurance Company

Japanese Life Insurance Companies

Takao Arai, Executive Vice President,
Nippon Life Insurance Company

Kazuma Ishii, Managing Executive Officer,
Dai-ichi Life Insurance Company

Koji Hanaoka, Managing Director,
Sumitomo Life Insurance Company

Hiroaki Tonooka, Managing Executive Officer,
Meiji Yasuda Life Insurance Company