April 20, 2006

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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The April IASB Meeting

Dear Sir David

At the April meeting of the IASB we understand that there will be discussion of several 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 these issues.

As was true in previous meetings in February and March, most of these issues have already been discussed at the Insurance Working Group (IWG) and are covered in the principles that we and the CFO Forum have already published. Some, however, may not have been thoroughly explored as of yet and on others, our position may not have been fully articulated at the IWG meetings. These comments primarily focus on life insurance, consistent with the agenda items, and are not intended to be a final and complete discussion of the issues but are the distilled result of our continuing discussions with users, preparers and other interested groups. Furthermore, they reflect insights gained by our efforts at modeling alternatives; a process that we believe should be critical to the Board's decision making process.

Measurement attribute. *What measurement attribute should be used for insurance liabilities? The staff will ask the Board to choose between the two models discussed at recent meetings (labeled 'current entry value' and 'current exit value').*

A measurement attribute using the only market transaction in the lifetime of an insurance contract—the premium agreed upon with the policyholder—is the most appropriate measurement basis. Except in limited cases, there are no appropriate market values to use in estimating 'exit value'. Where exceptions exist the reference values relate to only a relatively small part of the total liability. An attempt to require 'exit value' could lead to earnings manipulation and/or a lack of consistent fair value methods used by companies.

For life insurance, we recommend the following characteristics:

1) The Net Insurance Liability (or "Liability") should be based on the present value of all future cash flows associated with the portfolio of insurance contracts being valued.

a. The Net Insurance Liability should be equal to the present value of future benefits and expenses, without exception, less the present value of future gross premiums.
b. The basic assumptions should be developed in a manner consistent with the company's current best estimates of future experience.

2) The Net Insurance Liability at all times must be sufficient to provide for payment of all expected future obligations with adequate provision for risk and uncertainty. Margins should be changed if there is any conclusive evidence that margins are inadequate.

3) Profit should be recognized in line with the release from risk.

   a. Release of risk will generally be established based on expectations and margins inherent in the profit profile of the product (generally as reflected in pricing models).
   b. For claim reserve liabilities for which no margin is anticipated in pricing, the margin, if any, should reflect the risk inherent in the estimation technique.

4) On initial issue there should be no accounting gain or loss. The initial margins used for establishing the liability will therefore be those margins that result in no gain or loss at issue. However, in the event that an insurer issued a contract on which it anticipates an ultimate loss over the term of the contract, that loss should be recognized at issue with no expected future gain.

For non-life insurance, GNAIE believes the unearned premium approach is the most appropriate approach for pre-claims liability as the premium agreed-to by the policyholder and the insurer is usually the only market transaction in the lifetime of an insurance contract. GNAIE believes that non-life post-claims liabilities should be calculated without an explicit margin for risk and uncertainty. Attempting to calculate risk margin for short duration non-life claim liabilities by determining cash flows, discounting and applying an explicit risk margin will be impracticable, inconsistent and would lead to a significant cost burden on the preparer for little, if any, additional benefit to the user.

For life insurance policies there is typically uncertainty only on the timing of a claim. Typically for non-life there is uncertainty as to both the timing of and amount of loss payments. For example, auto insurance has uncertainty as to whether an insured will be involved in an auto accident in any given year, not to mention the challenge to predicting accurately the severity of any potential loss if an accident were to occur. Additional differences typically exist between life and non-life contracts once losses are incurred. Life related claims tend to settle relatively quicker, whereas non-life claims, particularly long-tailed business, may be reported after very long periods and even then may have protracted negotiation and/or settlement periods (e.g. asbestos and environmental claims). Based on such differences GNAIE believes that it is not tenable to use the same measurement attributes for both life and non-life contracts.

Unbundling. *Should an insurer unbundle the individual elements of an insurance contract and measure them individually?*

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.

Universal life contracts. *Universal life contracts give more discretion than traditional life insurance contracts to both policyholders and the insurer. How does such discretion affect recognition and measurement?*

Universal life contracts should be treated like all other life insurance contracts, consistent with our comments on Unbundling. Liabilities should be equal to the present value of future expected benefits and expenses, without exception, less the present value of future gross premiums. Future benefits should recognize expected non-guaranteed benefits that would arise naturally from the assumptions being used. The second paper from the IAA/ACLI task force dealt with this issue in some depth.

Unit-linked and index-linked payments. *How should an insurer:*

- *Measure obligations denominated in units of an internal or external investment fund?*
- *Measure and present the assets of an internal fund linked to such obligations?*
- *Account for revenue (e.g. investment management fees) and expense (including acquisition costs) related to such contracts?*
- *Measure guarantees of unit prices?*

Unit-linked contracts should be treated like all other life insurance contracts, consistent with our comments on Unbundling. The liability should be equal to the present value of future benefits and expenses, without exception, less the present value of future gross premiums. The discount rate should always be based on the expected return on the investments underlying the liability. In this way, the liability should be equal to the fund balance, except in early years when a surrender charge may cause the liability to be slightly less than the fund value.

Investment fees charged against the fund are not the same as the fees charged against, for instance, mutual funds. While those fees may appear to be investment fees, in reality they cover other risks such as mortality. The pricing of the product is done holistically and an attempt to separate the investment fees from the mortality charges will not faithfully represent the contract.

Guarantees of unit prices should be valued as part of the liability.

Profit margins. *Should margins be included in relation to explicit or implicit fees for future serves (e.g. future investment management fees)?*

Again, we don't believe that fees for future services should be separated for life insurance liabilities. The products are priced as a whole and one fee may cover more than one kind of risk.

Credit characteristics of insurance liabilities. *Should the measurement of insurance liabilities include the effect of their credit characteristics?*

The credit standing of an entity should not be considered in the valuation of insurance liabilities.

A system that results in a liability decreasing when a company's rating is decreased leads to a result that is misleading and confusing. Even if one assumes that liabilities only decrease when a company nears insolvency, the result is still inappropriate. Insurance regulation and other mechanisms in most jurisdictions guarantee payments to policyholders. Thus, a policyholder, in general, would not accept less than the contractual or face amount owed.

The insurance industry guarantee mechanisms provide greater security to policyholders than bondholders or other debt holders. Accordingly, the credit spread on a company's debt would not be an appropriate indicator of the credit risk, if any, associated with policyholder liabilities.

Since policyholder interests are met before debt holders (debt is subordinate to policyholder obligations), even in an insolvency, companies are often able to pay all their policyholder obligations while debt holders may receive substantially less than the face value of their investments, if they receive anything.

Unit of account. *At what level should insurance contracts be aggregated for measurement?*

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 on a consistent basis in successive reporting periods. Decisions concerning margins and unlocking should be made based on blocks of business related to the way the company manages its business. 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.

Participating Contracts.

We are aware that the IASB decided policyholder participation rights create a liability only under limited conditions. While not on the April agenda, we believe that the treatment of future dividends in participating contracts is an issue that needs further consideration. As we described in our letter for the March IASB meeting and in our extended life insurance principles, liabilities for participating contracts must include provisions for the expected payout of policyholder dividends. We hope the IASB will continue discussions on this topic at the June IWG meeting.

We hope that these brief comments will be of help to the Board in its upcoming discussions. Again, we appreciate that the Board and Staff have created the open process we have seen at the Insurance Working Group and look forward to participating in future meetings. If you or any Board Member would like clarification of our position on these issues, we would be glad to provide it.

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