



November 30, 2010

International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

**Exposure Draft – *Insurance Contracts***

The Financial Reporting Executive Committee (FinREC), formerly known as the Accounting Standards Executive Committee (AcSEC), and the Insurance Expert Panel, both of the American Institute of Certified Public Accountants, appreciate the opportunity to comment on the IASB Exposure Draft – *Insurance Contracts* (the ED). Additional input was also received from members of the AICPA Health Care Expert Panel and Employee Benefit Plans Expert Panel.

FinREC and the Insurance Expert Panel support the IASB’s goal to produce relevant and consistent IFRS information that is helpful to users of an insurer’s financial statements. We believe that U.S. generally accepted accounting principles (U.S. GAAP) comprehensively address accounting for insurance contracts by insurance entities, whereas IFRS does not provide consistent, comprehensive insurance contract accounting guidance.

Our comments in this letter have been prepared from the point of view of the proposed guidance in the ED as compared to IFRS 4, and does not address if we believe the proposals in the ED are an improvement to U.S. GAAP. We have addressed any comments on what we believe would represent the most appropriate course of action for U.S. GAAP in our letter to the FASB on their Discussion Paper, *Preliminary Views on Insurance Contracts*. We have attached our comment letter to the FASB as an appendix to this letter.

We are concerned with the prospect of the IASB and the FASB issuing different accounting standards for insurance contracts which would later need to be modified for convergence. We recommend that the IASB and FASB work to reconcile their accounting models and develop model(s) that are appropriate and accepted in all countries. Having one accounting model would eliminate entities from having to adopt multiple new accounting models for insurance contracts, which could be time consuming and costly.

We are concerned with how the measurement of insurance contracts under the ED coincides with the IFRS’s conceptual framework for the measurement of liabilities and the measurement models for cash outflows for all IASB projects. Specifically, we are concerned with how the Board has required the time value of money to be incorporated into the various measurement models. We recommend that the Boards develop a framework for applying the time value of money, to provide a consistent objective for determining how an appropriate discount rate should be selected, as we believe this issue is fundamental and far reaching beyond the insurance project. We are concerned that the required discount rates are inconsistent in several major projects and

standards (e.g., insurance contracts, revenue recognition, leases, contingencies, and pensions). For example, cash flows related to insurance contracts would be discounted at an adjusted current risk free rate, as compared to discounting pension liability at a high quality corporate bond rate, and as compared to the incremental borrowing rate proposed in the leasing project. In addition, there is inconsistency as to whether rates are locked in at inception or are dynamic current rates.

We do not fully support the model as currently proposed nor the proposed presentation of that model. However, we would support an adjusted model, and have provided suggestions on certain aspects of the proposed model to form an appropriate approach. In this respect we would suggest that the Board consider the following observations:

*Building Blocks – Present Value of the Fulfilment Cash Flows*

We believe that the measurement of an insurance contract should include the expected present value of future cash outflows less future cash inflows that arise as the insurer fulfills the insurance contract.

*Probability-Weighted Cash Flows:* We believe that the guidance that exists in the ED with regards to probability-weighted cash flows has resulted in inconsistent interpretation of the necessary data (scenarios) that would be required to develop the estimate. For example, many have read the guidance to indicate that all outcomes need to be used and that for certain contracts the extent of outcomes could be unlimited. We believe that the Board did not intend that all outcomes were necessary, and we therefore recommend that the guidance clarify that the probability-weighted cash flows is intended to represent an estimate of the mean.

As stated in paragraph B39 of the ED, the objective is not to identify every possible scenario but rather to incorporate all relevant information.

*Discount Rate:* We question whether using a risk free rate plus an adjustment for liquidity in a fulfillment model is the correct rate to use to discount non-participating insurance contract liabilities.

We are unclear as to how the liquidity adjustment should be determined. We believe that there should be an adjustment to the risk free rate, but we are unaware of existing theory of the valuation of financial instruments that provides sufficient guidance to assure that such an amount would be consistently determined by different entities.

*Risk and Residual Margins:* The definition and objective of the risk adjustment is unclear, and as a result, we do not believe that companies will be able to apply the concept consistently, resulting in lack of comparability among financial statement preparers. We are also concerned with the reliability of the proposed risk adjustment calculation, and whether such an approach may imply a false sense of precision in what will likely be a very subjective measurement.

Due to our concerns with the lack of comparability and subjectivity, we cannot support the use of a risk adjustment and residual margin. Conceptually we believe that if the risk adjustment were reliably estimable and could be calculated consistently between entities, then it would be relevant

to have the risk adjustment and residual margin presented separately to provide a view of how entities evaluate the change in risk over time. We prefer the use of a single composite margin, however we also believe that the proposed amortization formula for the composite margin should be studied further to determine if it meets its intended objective.

We do not understand what is meant by “the maximum amount the insurer would rationally pay to be relieved of the risk”. We recommend that if the risk adjustment is retained the wording in paragraphs B68 and BC105 of the ED be included in the final guidance as it provides some clarity on the objective of the risk adjustment:

“The risk adjustment directly measures the remaining risks in the contracts.”

We also recommend that if the risk adjustment is retained, the final guidance include illustrations of how to develop a risk adjustment with different fact patterns. We recommend that the Board engage the IASB Insurance Working Group to help develop this guidance as it is necessary for entities to consistently apply the guidance related to developing a risk adjustment.

### *Unbundling*

We agree that it is appropriate to unbundle certain components of an insurance contract if the components are clearly separate, and if the unbundling results in a better economic representation of all the components.

However, we are unclear as to the IASB’s interpretation of what components would be considered “not closely related” to the insurance coverage and unbundled, and believe this confusion could result in inconsistent application.

Therefore, we cannot conclude as to whether unbundling is appropriate, due to the uncertainty surrounding what components should be unbundled in the proposed guidance.

### *Modified Model*

We believe that entities should have the option of using the modified measurement approach for all contracts if the modified approach results in approximately the same liability in the pre-claim phase of the contract. We believe that the alternative model that we are proposing that uses a revised composite margin as a shock absorber would have substantially the same liability.

If the Board does not adopt our recommendations as discussed in our response to Question #6, we believe that the modified measurement approach will not approximate the Board’s proposed building block approach for the majority of contracts. This would restrict the amount of contracts that would be able to apply the proposed modified measurement model.

In that case, we would then recommend that the Board allow entities to have the option of using the modified measurement approach for all short-duration contracts (as defined in U.S. GAAP). We believe that a principle based standard should not include a bright line test (i.e., 12 months) to determine which contracts should apply a measurement approach.

### *Reinsurance*

The majority of FinREC and the Insurance Expert Panel do not object to the proposed guidance for reinsurance contracts allowing a Day 1 gain by the cedant if the expected present value of future cash inflows plus the risk adjustment exceed the expected present value of future cash flows, as a transfer of risk exists through the reinsurance contract.

However, a minority of FinREC and the Insurance Expert Panel believe that gain recognition upon entering into a reinsurance contract would be inconsistent with the concept in the ED of no Day 1 gain for direct written insurance contracts, and could result in accounting arbitrage. These members reject the idea that risk transfer leads to gain recognition, given that the obligation to the policyholder has not been extinguished nor recognized as an extinguishment for accounting purposes.

We also believe additional guidance is needed on the scope of contracts subject to the premium allocation approach, specifically as it relates to reinsurance contracts. Specifically, should an entity look through to the underlying reinsured contracts, or to the terms and coverage of the reinsurance contract itself.

### *Presentation*

We believe that the issue of presentation of income and expense arising from insurance contracts is complex, and depends on the type of insurance product. There are merits to presenting income and expense in either the proposed summarized margin approach or a traditional premiums and claims insurance approach, depending on the type of insurance product and whether consideration received for insurance contracts meets the definition of revenue or should be considered a deposit. We believe it is important to have certain of this critical information, such as volume indicators, on the face of the statement of comprehensive income rather than in the footnotes or a supplemental schedule.

We are also concerned that the bright line for determining what contracts should be accounted for under the modified measurement model, will result in some short duration contracts with similar characteristics and economics being presented under two different presentation approaches.

### *Transition*

We recommend that the Board reconsider the proposed transition requirements, and determine a transition method that allows for the emergence of the future profit stream from inforce contracts. We also recommend that the Board consult with constituents and conduct field testing to determine what type of transition methodology is feasible.

Our answers to the specific questions in the ED provide more detail on the views expressed above and are attached in the Appendix to this letter.

Yours truly,

Jay Hanson, Chair  
Financial Reporting Executive Committee

Richard Lynch, Chair  
Insurance Expert Panel

## Appendix A

### Response to Questions: IASB Exposure Draft: *Insurance Contracts*

#### Question 1 – Relevant information for users

(paragraphs BC13–BC50)

**Do you think that the proposed measurement model will produce relevant information that will help users of an insurer’s financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why?**

FinREC and the Insurance Expert Panel (hereafter referred to as “we”) support the IASB’s goal to produce relevant information that is helpful to users of an insurer’s financial statements. However, due to our concerns with the lack of a clearly defined objective for the risk adjustment and the questionable cost/benefit of separately measuring this component which may not be capable of being reliably estimated on a consistent basis, we feel that the proposed explicit risk adjustment measurement approach may not produce reliable information for users of an insurer’s financial statements, resulting in a complicated measurement approach that is not relevant.

Therefore we prefer the use of a single composite margin in determining the measurement of an insurance contract.

#### Question 2 – Fulfillment cash flows (paragraphs 17(a), 22–25, B37–B66 and BC51)

**(a) Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?**

**(b) Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?**

A) Yes, we believe that the measurement of an insurance contract should include the expected present value of future cash outflows less future cash inflows that arise as the insurer fulfills the insurance contract.

We believe that the various guidance that exists in the ED with regards to probability-weighted cash flows, has resulted in inconsistent interpretation of the necessary data (scenarios) that would be required to develop the estimate. For example, many have read the guidance to indicate that all outcomes need to be used and that for certain contracts the extent of outcomes could be unlimited. We believe that Board did not intend that all outcomes were necessary, and we therefore recommend that the guidance clarify that the probability-weighted cash flows is intended to represent an estimate of the mean.

B) We believe that the guidance in Appendix B of the ED should provide additional detail on the following:

1 Maintenance Costs and Overhead - Paragraphs B61(g) and B62(f) of the ED: We believe the description of maintenance costs is too generic for entities to consistently determine what costs should be considered maintenance versus overhead. We request that the

Board provide clarification, such as additional examples, on what costs are considered maintenance or overhead.

- 2 Policy loans: It is unclear whether the intention is to include policy loans as part of contract cash flows for measurement purposes or whether they would be deemed to be not closely related and accounted for separately. We request that the Board address whether policy loans should be included or not included when estimating cash flows, as it is not addressed in either paragraph B61 or B62 of the ED.

**Question 3 – Discount rate (paragraphs 30–34 and BC88–BC104)**

**(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?**

**(b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?**

**(c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not?**

**If they are valid, what approach do you suggest and why?**

**For example, should the Board reconsider its conclusion that the present value of the fulfillment cash flows should not reflect the risk of non-performance by the insurer?**

- A) We recommend that the Board develop a framework for applying the time value of money, to provide a consistent objective for determining how an appropriate discount rate should be selected as we believe this issue is fundamental and far reaching beyond the insurance project. We are concerned that the required discount rates are inconsistent in several major projects and standards (e.g., insurance contracts, revenue recognition, leases, contingencies, and pensions), without having a framework to evaluate if the required discount rates are appropriate.

In response to the ED, we question whether using a risk free rate plus an adjustment for liquidity in a fulfillment model is the appropriate rate to use to discount non-participating insurance contract liabilities. However, we agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability to the extent possible (e.g., for certain insurance contracts there may be no observable financial instrument having characteristics similar to the insurance contracts).

We also believe that in situations where there is a direct pass through to the policyholder benefits from the assets backing the insurance liability, the rate of those assets should be considered in the discount rate.

- B) We are unclear as to how the liquidity adjustment should be determined. We believe that there should be an adjustment to the risk free rate, but we are unaware of existing theory of the valuation of financial instruments that provides sufficient guidance to assure that such an amount would be consistently determined by different entities.

- C) We believe that these concerns are valid due to the fact that a risk free rate plus liquidity adjustment does not reflect the economics of a contract. For example, a fixed annuity or universal life account balance would typically be credited with a rate that exceeds the risk free rate but would be required to be discounted at risk free, resulting in a potential day 1 loss that does not reflect economic reality.

#### **Additional Comments:**

##### **Time Value of Money:**

We acknowledge that the overall IFRS principle is that the time value of money is relevant, and agree that the inclusion of probability-weighted cash flows adjusted for the time value of money produces relevant information. However, we recommend that the final guidance include explicit discussion that if the time value of money is immaterial for specific short-duration insurance contracts, it can then be ignored.

##### **Question 4 – Risk adjustment versus composite margin (paragraphs BC105–BC115)**

**Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favors)? Please explain the reason(s) for your view.**

Due to our concerns with the lack of comparability and subjectivity, we cannot support the use of a risk adjustment and residual margin. In this light, the Board’s language in paragraphs BC 109-110 of the ED appears internally inconsistent. That is, the Board describes the risk adjustment as the amount an insurer would rationally pay to be relieved from risk, but goes on to state that the risk adjustment does not represent the compensation a market participant would require for bearing risk. It is unclear to us *who* an insurer would pay in a hypothetical transaction to relieve itself from risk if the counterparty is not a market participant with a profit motive.

Conceptually we believe if the risk adjustment was reliably estimable and could be calculated consistently between entities, then it would be relevant to have the risk adjustment and residual margin presented separately to provide a view of how entities evaluate the change in risk over time. Therefore, we prefer the use of a single composite margin, however we also believe that the subsequent measurement of the composite margin would need to be clarified before it could be properly operationalized.

##### **Question 5 – Risk adjustment (paragraphs 35-37, B67-B103 and BC105–BC123)**

- (a) Do you agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?**
- (b) Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. Do you**



**agree that these three techniques should be allowed, and no others? Why or why not? If not, what do you suggest and why?**

**(c) Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90(b)(i))? Why or why not?**

**(d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (i.e. a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?**

**(e) Is the application guidance in Appendix B on risk adjustments at the right level of detail? Do you have any comments on the guidance?**

A) The definition and objective of the risk adjustment is unclear, and as a result, we do not believe that companies will be able to apply the concept consistently, resulting in lack of comparability among financial statement preparers. We are also concerned with the reliability of the proposed risk adjustment calculation, and whether such an approach may imply a false sense of precision in what will likely be a very subjective measurement. Consequently, we do not support the use of the risk adjustment as proposed in the ED.

We do not understand what is meant by “the maximum amount the insurer would rationally pay to be relieved of the risk”. We recommend that the wording in paragraphs B68 and BC105 of the ED be included in the final guidance as it provides some clarity on the objective of the risk adjustment:

“The risk adjustment directly measures the remaining risks in the contracts.”

We also recommend that the final guidance include illustrations of how to develop a risk margin with different fact patterns such as instances that have similar estimates of the mean but with very different distribution of potential results. We recommend that the Board engage the IASB Insurance Working Group to help develop this guidance as it is necessary for entities to consistently apply the guidance related to developing a risk margin. The Insurance Expert Panel would also be willing to be involved with the development of these examples.

B) We believe, to be consistent with the goal of principle based standard setting, the final guidance should not limit the techniques used for estimating risk adjustments. We believe the final guidance should clearly express the objective of the risk margin, provide illustrative examples of how to calculate the risk margin, provide a listing of criteria to be considered within different techniques for calculating the risk margin, and allow entities to use their judgment to determine the best method. We are concerned that limitations on the allowable methods to be used for estimating the risk adjustment could be an indicator of weakness in the principle surrounding the risk adjustment, and recommend that the Board concentrate on strengthening the principle rather than limit the allowable techniques.

C) We believe it is important that entities disclose what method is used to estimate the risk adjustment and why that method was selected, including factors that were considered during the process of evaluating uncertainty about the amount and timing of cash flows. Disclosure

of this information is important to users of financial statements as the users should be able to understand how the entity calculated the risk adjustment, allowing the user to consider these amounts based on their own expectations.

- D) Yes, we agree that an insurer should measure the risk adjustment at a portfolio level of aggregation, rather than reflecting diversification across portfolios.
- E) We recommend that the application guidance in Appendix B of the ED focus on including factors to consider when making the estimate of the risk margin, but not limit what approaches should be used.

#### **Additional Comments:**

##### **Cost of Capital:**

We are concerned that the cost of capital technique described in the ED is one variation generally used to calculate cost of capital based on regulatory considerations. If the final guidance mandates the use of certain techniques for estimating the risk adjustment, we request clarification that entities should use the type of cost of capital technique best suited to their economic nature of the contracts, not based on regulatory environment.

##### **Question 6 – Residual/composite margin (paragraphs 17(b), 19–21, 50–53 and BC124–BC133)**

- (a) Do you agree that an insurer should not recognize any gain at initial recognition of an insurance contract (such a gain arises when the expected present value of the future cash outflows plus the risk adjustment is less than the expected present value of the future cash inflows)? Why or why not?**
- (b) Do you agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognized immediately in profit or loss (such a loss arises when the expected present value of the future cash outflows plus the risk adjustment is more than the expected present value of future cash inflows)? Why or why not?**
- (c) Do you agree that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period? Why or why not? If not, what do you recommend and why?**
- (d) Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why (see paragraphs 50 and BC125–BC129)?**
- (e) Do you agree with the proposed method(s) of releasing the composite margin, if the Board were to adopt the approach that includes such a margin (see the Appendix to the Basis for Conclusions)? Why or why not?**
- (f) Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131–BC133)? Why or why not?**

**Would you reach the same conclusion for the composite margin? Why or why not?**

- A) Yes, we agree with the principle that an insurer should not recognize any gain at initial recognition of an insurance contract.

- B) Yes, we agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognized immediately in profit or loss.
- C) Yes, we agree that an insurer should estimate the residual or composite margin at a level that aggregates into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period, as that is the level needed for release of the margin.
- D) We do not agree with the proposed method of releasing the residual margin. If the IASB general measurement model is applied, we believe that instead of the locked-in amortization method proposed in the ED, a retrospective cumulative catch-up approach should be used to amortize the residual margin. Under this method, the residual margin would be remeasured each period as of the inception date of the contract using current cash flow estimates (including actual cash flow experience to date). The revised inception date residual margin would then be amortized over the coverage period with any cumulative adjustment taken in the current period. However, the IASB would need to work with industry to ensure such an approach can practically be applied.

If such a retrospective cumulative catch-up approach is deemed to be not practical and economical to apply, we recommend that the residual margin should offset the changes in the other components of the building blocks as a “shock absorber”. The residual margin would offset any increases in the probability-weighted estimate of future cash flows or increases in the risk adjustment over the coverage period. The remaining residual margin (if any) would be amortized over the remaining coverage period.

We believe that disclosure explaining changes in the residual margin under either method would be needed.

- E) If the IASB were to adopt an approach that includes a composite margin, a majority of FinREC and the Insurance Expert Panel recommend that the composite margin should offset any increases in the probability-weighted estimate of future cash flows as a “shock absorber”. The remaining composite margin (if any) would be amortized over the remaining coverage plus claim payment period.

We were not able to obtain unanimous agreement on this concept, and recommend that the Board study in greater depth how the composite margin should be released, and also consider whether any type of liability adequacy test should be imposed if the composite margin is used as a shock absorber. When using the composite margin as a shock absorber, the liability would only represent the present value of the mean and some believe that could result in a liability that is not sufficient.

We also note that the ED currently includes no guidance on how the modified approach would work with the composite margin approach during the post-claim period. We recommend that additional information be included as to whether, under the modified model, a composite margin or other additional liability should be determined in the post-claim period, and if it would be released in a similar manner as it would be under the building block approach.

- F) We do not believe interest should be accreted on the residual margin, as it appears to inflate profits and losses by recording interest expense when accreted to the residual margin and profit when it is amortized through the release of the residual margin.

**Question 7 – Acquisition costs (paragraphs 24, 39 and BC135–BC140)**

**(a) Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition costs should be recognized as expenses when incurred? Why or why not? If not, what do you recommend and why?**

We understand the concept and believe it is appropriate to include incremental acquisition costs for contracts issued in the initial measurement of the contract. We note that this accounting is consistent with the guidance in IAS 39 for contracts measured at amortized cost, but acknowledge an inconsistency with the guidance in the proposed Revenue Recognition Exposure Draft.

We also believe that the Board should consider expanding the definition of acquisition costs to be included in cash flows to align it with FASB ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts.

We also request clarification on how the following items should be evaluated for inclusion as acquisition costs within the contract cash flows:

- Volume contracts: Would the incremental costs of selling, underwriting and initiating a group of contracts be included in the initial measurement of insurance contract cash flows if those costs cannot be identified at the individual insurance contract level?
- Timing: Would costs incurred prior to the issuance of the contract, for example inspection fee costs, be considered incremental?

**Question 8 – Premium allocation approach**

**(a) Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?**

**(b) Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?**

We believe that entities should have the option of using the modified measurement approach for all contracts if the modified approach results in approximately the same liability in the pre-claim phase of the contract. We believe that the alternative model that we are proposing that uses a revised composite margin as a shock absorber would have substantially the same liability.

If the Board does not adopt our recommendations as discussed in our response to Question #6, we believe that the modified measurement approach will not approximate the Board's proposed building block approach for the majority of contracts. This would restrict the amount of contracts that would be able to apply the proposed modified measurement model.

In that case, we would then recommend that the Board allow entities to have the option of using the modified measurement approach for all short-duration contracts (as defined in U.S. GAAP). We believe that a principle based standard should not include a bright line test (i.e., 12 months) to determine which contracts should apply a measurement approach.

#### **Question 9 – Contract boundary principle**

**Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?**

Conceptually, we agree with the proposed boundary principle in the ED, but we are not sure how it should be interpreted for contracts that have regulatory restrictions on pricing. We believe that the ability to reassess the risk of a policyholder (as discussed in paragraph 27 (b) of the ED) should not require individual contract repricing, if the contracts themselves are only priced on a group basis, and can be repriced for the entire group (for example, health insurance contracts under the new reforms).

We request clarification on the guidance in paragraph 27(b) of the ED, for determining the boundary of an insurance contract when the price of a specific rider within the contract can be reset by the insurer to current market rates. Would the requirement for resetting the price apply to the entire contract, or could it be applied to parts within the contract (e.g., riders)?

As discussed in our response to Question #16, we also request clarification on how the proposed guidance should be applied to reinsurance contracts. Would the contract boundary of a reinsurance contract be defined by the period of the reinsurance contract or the underlying contract reinsured?

#### **Question 10 – Participating features**

**(a) Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?**

**(b) Should financial instruments with discretionary participation features be within the scope of the IFRS on insurance contracts, or within the scope of the IASB's financial instruments standards? Why?**

**(c) Do you agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contracts must participate with**

**insurance contracts in the same pool of assets, company, fund or other entity? Why or why not? If not, what do you recommend and why?**

**(d) Paragraphs 64 and 65 modify some measurement proposals to make them suitable for financial instruments with discretionary participation features. Do you agree with those modifications? Why or why not? If not, what would you propose and why? Are any other modifications needed for these contracts?**

- A) Yes, we agree that the measurement of insurance contracts should include participating benefits on an expected present value basis.
- B) We believe that financial instruments with discretionary participation features (DPF) should be included in the scope of the IASB's financial instruments standard, and not the scope of the insurance contracts standard. We do not understand why financial instruments with DPF would be included in the scope of the insurance contracts standard as they do not meet the definition of an insurance contract.
- C) We believe that financial instruments with no insurance risk, regardless of how they are defined should not be included in the insurance standard.
- D) We believe that financial instruments with DPFs should be included in the scope of the IASB's financial instruments standard, and not the scope of the insurance contracts standard.

#### **Question 11 – Definition and scope**

**(a) Do you agree with the definition of an insurance contract and related guidance, including the two changes summarized in paragraph BC191? If not, why not?**

**(b) Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?**

**(c) Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?**

- A) We do not object to the proposed definition of an insurance contract and the related guidance but observe that including remote scenarios in determining risk transfer (which we understand is a continuation of IFRS 4) appears to permit contracts with little insurance risk to be accounted for as insurance contracts.

We also request that the Board provide clarity as to the meaning of commercial substance in paragraph B25 in the ED, when describing that, “a contract does not transfer insurance risk if there is no scenario that has commercial substance in which the present value of the net cash outflows paid by the insurer can exceed the present value of the premiums.”

- B) We believe there is a lack of clarity with the scope exclusion in paragraph 4(e) of the ED, related to what contracts are included as fixed-fee service contracts that have the primary purpose of provision of services.

We request that the Board clarify that any entity that writes insurance contracts in which goods or services are provided to the policyholder to compensate for insured events should apply the guidance in the ED. The current definition of an insurer as described in Appendix A of the ED, and the wording of the second sentence of paragraph 4(e) of the ED, could be confusing as to whether this guidance would only apply to an entity legally organized as an insurer that has written the policy or to any entity that writes an insurance contract. We believe it is not the intention of the Board to propose different accounting for similar contracts written by different entities.

We also request clarification on how the guidance in paragraph B17 of the ED, “an insurer can accept significant insurance risk from a policyholder **only if the insurer is an entity separate from the policyholder**”, should be applied to insurance contracts between affiliated entities. For example, a corporate owned life insurance (COLI) contract that is issued between subsidiaries. Would the contract between the affiliates be considered an insurance contract at the subsidiary level?

- C) We request that the Board provide a clear basis of explanation as to why financial guarantee contracts should or should not be included, and if the contracts include insurance risk.

#### **Additional Comments:**

#### **Letters of Credit:**

We request clarification as to what is meant in paragraph B22 of the ED where it notes that some types of letters of credit would be considered insurance contracts. We request that the Board provide additional information as to what type of letters of credit would be considered insurance contracts.

#### **Question 12 – Unbundling**

**Do you think it is appropriate to unbundle some components of an insurance contract? Do you agree with the proposed criteria for when this is required? Why or why not? If not, what alternative do you recommend and why?**

We agree that it is appropriate to unbundle certain components of an insurance contract, if the components are clearly separate, and if the unbundling results in a better economic representation of all the components.

However, we are unclear as to the IASB’s interpretation of what components would be considered “not closely related” to the insurance coverage and unbundled, and believe this confusion could result in inconsistent application. Therefore, we cannot conclude as to whether unbundling is appropriate, due to the uncertainty surrounding what components should be unbundled in the proposed guidance.

We believe it is the intent of the Board to require unbundling for certain universal life-type contracts with guarantees, but the inclusion of the criteria in paragraph 8 (a)(ii) of the ED would result in these types of contracts being deemed closely related to the insurance coverage due to

the requirement that the crediting rate must pass on to the individual policyholder all investment performance.

### **Question 13 – Presentation**

**(a) Will the proposed summarized margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?**

**(b) Do you agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?**

A) We are concerned that the proposed summarized margin presentation would be confusing to users of financial statements. We are also concerned that the new presentation approach could result in the creation of new non-GAAP measures to help insurers further explain their financial statements.

B) We believe that the issue of presentation of income and expense arising from insurance contracts is complex, and dependent on the type of insurance product. There are merits to presenting income and expense in either the proposed summarized margin approach or a traditional premiums and claims insurance approach, based on the type of insurance product and whether consideration received for insurance contracts meets the definition of revenue or should be considered a deposit. We believe it is important to have certain of this critical information, such as volume indicators, on the face of the statement of comprehensive income rather than in the footnotes or a supplemental schedule.

We are also concerned that the bright line for determining what contracts should be accounted for under the modified measurement model, will result in some short duration contracts with similar characteristics and economics being presented under two different presentation approaches. This inconsistency would result in confusion by users of financial statements.

### **Question 14 – Disclosures**

**(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?**

**(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?**

**(c) Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.**

A) Yes, we agree with the proposed disclosure principle of including qualitative and quantitative information about the amounts recognized in the financial statements from insurance contracts, and the nature and extent of risks arising from insurance contracts, as this is useful information for users of financial statements.

The proposed disclosure requirements include many specific and detailed disclosures that we believe are excessive and will likely obscure the information that financial statement users will find necessary and useful. Specifically we are concerned that to comply with paragraph



91 of the ED and provide sufficient detail to help users evaluate the sensitivity to insurance risks, would require detailed disclosures at the portfolio level.

- B) We are also concerned that the proposed disclosure requirements would result in shifting disclosures from the unaudited management discussion and analysis (MD&A) section into the financial statement footnotes.
- C) We do not believe that there are any other disclosures that should be included.

### **Question 15 – Unit-linked contracts**

**Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?**

Under the ED, we believe that most unit-linked contracts would be unbundled and accounted for under separate guidance, not under the insurance contracts guidance. Therefore we believe that the guidance for presentation for unit linked contracts should be included in that applicable guidance.

We believe that there are other aspects of accounting to be considered for unit-linked contracts that have not been addressed by the ED, but are included in U.S. GAAP (FASB ASC 944-80, Financial Services – Insurance – Separate Accounts), such as: gains and losses on the transfer of assets from the general account to the separate account, and how investments held through separate accounts affect an insurer’s consolidation analysis of those investments.

We recommend that this guidance be thoroughly considered in developing the final standard or other guidance that is applicable to unit-linked contracts.

### **Question 16 – Reinsurance**

**(a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?**

**(b) Do you have any other comments on the reinsurance proposals?**

The majority of FinREC and the Insurance Expert Panel do not object to the proposed guidance for reinsurance contracts allowing a Day 1 gain by the cedant if the expected present value of future cash inflows plus the risk adjustment exceed the expected present value of future cash flows, as a transfer of risk exists through the reinsurance contract.

However, a minority of FinREC and the Insurance Expert Panel believe that gain recognition upon entering into a reinsurance contract would be inconsistent with the concept in the ED of no Day 1 gain for direct written insurance contracts, and might result in accounting arbitrage. These members reject the idea that risk transfer leads to gain recognition, given that the obligation to the policyholder has not been extinguished nor recognized as an extinguishment for accounting purposes.

We request additional guidance on how the risk adjustment should be calculated for reinsurance contracts, whether it should be on a net or gross basis.

We also believe additional guidance is needed on the scope of contracts subject to the premium allocation approach, specifically as it relates to reinsurance contracts. Specifically, should an entity look through to the underlying insured risk, or to the terms and coverage of the reinsurance contract itself? For example; a reinsurance contract with risk attachment for contracts written in a 12 month period that covers actual claims for a 24 month period; in this situation we are uncertain if this contract would qualify for the modified measurement approach.

**Question 17 – Transition and effective date**

**(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?**

**(b) If the Board were to adopt the composite margin approach favored by the FASB, would you agree with the FASB’s tentative decision on transition (see the appendix to the Basis for Conclusions)?**

**(c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?**

**(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.**

We recommend that the Board reconsider the proposed transition requirements, and determine a transition method that allows for the emergence of the future profit stream from inforce contracts. We also recommend that the Board consult with constituents and conduct field testing to determine what type of transition methodology is feasible.

We believe it is necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9.

**Question 18 – Other comments**

**Do you have any other comments on the proposals in the exposure draft?**

**Question 19 – Benefits and costs**

**Do you agree with the Board’s assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.**



## Appendix B

November 30, 2010

Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

### **Discussion Paper– *Preliminary Views on Insurance Contracts* File Reference No. 1870-100**

The Financial Reporting Executive Committee (FinREC), formerly known as the Accounting Standards Executive Committee (AcSEC), and the Insurance Expert Panel, both of the American Institute of Certified Public Accountants, appreciate the opportunity to comment on the FASB Discussion Paper– *Preliminary Views on Insurance Contracts* (the DP). Additional input was also received by members of the AICPA Health Care Expert Panel and Employee Benefit Plans Expert Panel.

FinREC and the Insurance Expert Panel support the goal of the FASB and the IASB to produce relevant and consistent information that is helpful to users of an insurer’s financial statements. We note that U.S. generally accepted accounting principles (GAAP) comprehensively addresses accounting for insurance contracts by insurance entities, whereas IFRSs do not have comprehensive insurance guidance.

We are concerned with how the measurement of insurance contracts coincides with the measurement models for cash out flows for all FASB and IASB projects. We recommend that the Board develop a framework for applying the time value of money, to provide a consistent objective for determining how an appropriate discount rate should be selected, as we believe this issue is fundamental and far reaching beyond the insurance project. We are concerned that the required discount rates are inconsistent in several major projects and standards (e.g., insurance contracts, revenue recognition, leases, contingencies, and pensions) and there does not appear to be a framework to objectively evaluate whether those discount rates are appropriate for the specific expected cash outflows. For example, cash flows related to insurance contracts would be discounted at an adjusted current risk free rate, as compared to discounting pension liability at a high quality corporate bond rate, and as compared to the incremental borrowing rate proposed in the leasing project. In addition, there is inconsistency as to whether rates are locked in at inception or are dynamic current rates.

We are concerned with the prospect of the IASB and the FASB issuing different accounting standards for insurance contracts, with the notion that the accounting standards would later need to be modified for convergence. Having a common accounting model would eliminate entities from having to adopt another new accounting model upon convergence. We are very concerned with the possibility of having U.S. GAAP preparers implement major changes multiple times,

first for targeted changes to U.S. GAAP and later to the IFRS model, in a relatively short period of time, as it could be time consuming and costly.

If the Board does not realistically expect to converge with the IASB within the near term (for example, seven to ten years) on accounting for insurance contracts, we then recommend that the FASB should not make any changes to U.S. GAAP as we believe trying to change individual pieces without examining the full model would not be feasible, as the individual pieces are integral to the overall model.

If the Board's objective is to converge with the IASB on accounting for insurance contracts in the near future, then we strongly recommend that the next steps should be for the Board to work with the IASB to reconcile their accounting models starting from the FASB's preliminary views. However, we believe certain aspects of the Board's preliminary views should be modified to provide clear, effective, relevant guidance to all preparers and users of insurance company financial statements. We would suggest that the Board consider the following observations:

*Probability-Weighted Cash Flows:* We believe that the guidance that exists in the ED with regards to probability-weighted cash flows has resulted in inconsistent interpretation of the necessary data (scenarios) that would be required to develop the estimate. For example, many have read the guidance to indicate that all outcomes need to be used and that for certain contracts the extent of outcomes could be unlimited. We believe that Board did not intend that all outcomes were necessary, and we therefore recommend that the guidance clarify that the probability-weighted cash flows is intended to represent an estimate of the mean. As stated in the IASB ED, the objective is not to identify every possible scenario but rather to incorporate all relevant information.

*Discount Rate:* We question whether using a risk free rate plus an adjustment for liquidity in a fulfillment model is the correct rate to use to discount non-participating insurance contract liabilities. We recommend that the Board develop a framework for applying the time value of money, to provide a consistent objective for determining how an appropriate discount rate should be selected.

We are unclear as to how the liquidity adjustment should be determined. We believe that there should be an adjustment to the risk free rate, but we are unaware of existing theory of the valuation of financial instruments that provides sufficient guidance to assure that such an amount would be consistently determined by different entities.

*Composite Margin:* Due to the lack of clarity around what the risk adjustment, as described in the IASB ED, is intended to represent, we prefer the use of a single composite margin. In this light, the Board's language in paragraphs BC 109-110 of the ED appears internally inconsistent. That is, the Board describes the risk adjustment as the amount an insurer would rationally pay to be relieved from risk, but goes on to state that the risk adjustment does not represent the compensation a market participant would require for bearing risk. It is unclear to us *who* an insurer would pay in a hypothetical transaction to relieve itself from risk if the counterparty is not a market participant with a profit motive.

Conceptually we believe if the risk adjustment was reliably estimable and could be calculated consistently between entities, than it would be relevant to have the risk adjustment presented separately to provide a view of how entities evaluate the change in risk over time.

We prefer the use of a single composite margin, however we also believe that the proposed amortization formula for the composite margin should be studied further to determine if it meets its intended objective

*Unbundling:* We are unclear as to the Boards' interpretation of what components would be considered "not closely related" to the insurance coverage and unbundled, and believe this confusion could result in inconsistent application. We cannot conclude as to whether unbundling is appropriate, due to the uncertainty surrounding what components should be unbundled in the proposed guidance.

*Modified Approach:* We believe that entities should have the option of using the modified measurement approach for all contracts if the modified approach results in approximately the same liability in the pre-claim phase of the contract. We believe that the alternative model that we are proposing that uses a revised composite margin as a shock absorber would have substantially the same liability.

If the Board does not adopt our recommendations as discussed in our response to Question #16, we believe that the modified measurement approach will not approximate the Board's proposed building block approach for the majority of contracts. This would restrict the amount of contracts that would be able to apply the proposed modified measurement model.

In that case, we would then recommend that the Board allow entities to have the option of using the modified measurement approach for all short-duration contracts (as defined in U.S. GAAP). We believe that a principle based standard should not include a bright line test (i.e., 12 months) to determine which contracts should apply a measurement approach.

*Presentation:* We believe that the issue of presentation of income and expense arising from insurance contracts is complex, and depends on the type of insurance product. There are merits to presenting income and expense in either the proposed summarized margin approach or a traditional premiums and claims insurance approach, depending on the type of insurance product and whether consideration received for insurance contracts meets the definition of revenue or should be considered a deposit. We believe it is important to have certain of this critical information, such as volume indicators, on the face of the statement of comprehensive income rather than in the footnotes or a supplemental schedule.

Our answers to the specific questions in the DP provide more detail on the views expressed above and are attached in the Appendix to this letter. We have also attached as reference our comment letter to the IASB as an appendix to this letter.

Yours truly,

Jay Hanson, Chair  
Financial Reporting Executive Committee

Richard Lynch, Chair  
Insurance Expert Panel

## Appendix A

### Response to Questions: FASB Discussion Paper: *Preliminary Views on Insurance Contracts*

#### Definition and Scope

##### **1. Are the proposed definitions of *insurance contract* and *insurance risk* (including the related guidance) understandable and operational?**

We do not object to the proposed definition of an insurance contract and the related guidance but observe that including remote scenarios in determining risk transfer (which we understand is a continuation of IFRS 4) appears to permit contracts with little insurance risk to be accounted for as insurance contracts.

We also request that the Board provide clarity as to the meaning of commercial substance in paragraph B25 in the IASB ED, when describing that, “a contract does not transfer insurance risk if there is no scenario that has commercial substance in which the present value of the net cash outflows paid by the insurer can exceed the present value of the premiums.”

##### **2. If the scope of the proposed guidance on insurance contracts is based on the definition of an insurance contract rather than on the type of entity issuing the contract, would financial reporting be improved?**

Yes, we believe it would be an improvement to financial reporting to have the scope of the proposed guidance on insurance contracts based on the definition of an insurance contract rather than on the type of entity issuing the contract.

In our response to the IASB ED, we have requested that the IASB clarify that any entity that writes insurance contracts in which goods or services are provided to the policyholder to compensate for insured events, should apply the guidance in the IASB ED. The current definition of an insurer as described in Appendix A of the IASB ED, and the wording of the second sentence of paragraph 4 (e) of the IASB ED, could be confusing as to whether this guidance would only apply to an insurer that has written the policy or to any entity that writes an insurance contract. We believe it is not the intention of the Board to propose different accounting for similar contracts written by different entities.

##### **3. Do you agree with the proposed scope exclusions? Why or why not?**

We believe there is a lack of clarity with the scope exclusion in paragraph 4 (e) of the IASB ED, related to what contracts are included as fixed-fee service contracts that have the primary purpose of provision of services.

##### **4. Should benefits that an employer provides to its employees that otherwise meet the definition of an insurance contract be within the scope of the proposed guidance? Why or why not?**

We believe that benefits that an employer provides to its employees should not be within the scope of this proposed guidance, as it is compensation and should be measured consistently with other benefits.

**5. The Board’s preliminary view is that participating investment contracts should not be accounted for within the proposed model for insurance contracts but, rather, should be included in the scope of the proposed model for accounting for financial instruments. Do you agree? Why or why not?**

Yes, we believe that financial instruments with discretionary participation features (DPF) should not be accounted for within the proposed model for insurance contracts but, rather, should be included in the scope of proposed model for accounting for financial instruments, since financial instruments with DPF do not meet the definition of an insurance contract.

**6. Do you support the approach for determining when noninsurance components of contracts should be unbundled? Why or why not?**

We are unclear as to what components would be considered “not closely related” to the insurance coverage and unbundled, and believe this confusion could result in inconsistent application. Therefore, we cannot conclude as to whether unbundling is appropriate, due to the uncertainty surrounding what components should be unbundled in the proposed guidance.

We believe it is the intent of the Boards to require unbundling for certain universal life-type contracts with guarantees, but the inclusion of the criteria in paragraph 8 (a)(ii) of the IASB ED would result in these types of contracts being deemed closely related to the insurance coverage due to the requirement that the crediting rate must pass on to the individual policyholder all investment performance.

### **Recognition and Measurement**

**7. Do you agree with the use of the probability-weighted estimate of net cash flows to measure insurance contracts? Does that approach faithfully represent the economics of insurance contracts? Is it an improvement over existing U.S. GAAP?**

Yes, we agree with the use of probability-weighted estimates of net cash flows, but recommend that the final guidance clarify that the probability-weighted cash flows is intended to represent an estimate of the mean. We believe that the guidance that exists in the IASB ED with regards to probability-weighted cash flows has resulted in inconsistent interpretation of the necessary data (scenarios) that would be required to develop the estimate. For example, many have read the guidance to indicate that all outcomes need to be used and that for certain contracts the extent of outcomes could be unlimited. We believe that Board did not intend that all outcomes were necessary.

**8. Do you think that an entity’s estimate of the net cash flows should include a risk adjustment margin?**

Yes, we agree conceptually that an entity’s estimate of the net cash flows should include a risk adjustment margin to provide measurement for the risk in the contracts. However, as noted in



our response to Question #9, we believe that companies will not be able to apply the concept consistently, resulting in lack of comparability among financial statement preparers. We are also concerned with the reliability of the proposed risk adjustment calculation, and whether such an approach may imply a false sense of precision in what will likely be a very subjective measurement. Therefore, we cannot support the use of a risk adjustment and residual margin as proposed in the IASB ED.

**9. Is the objective of the risk adjustment margin understandable? If so, do you think that the techniques for estimating the risk adjustment margin (see paragraph 52(b)), faithfully represent the maximum amount that the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected?**

The definition and objective of the risk adjustment is unclear, and as a result, we do not believe that companies will be able to apply the concept consistently, resulting in lack of comparability among financial statement preparers. We are also concerned with the reliability of the proposed risk adjustment calculation, and whether such an approach may imply a false sense of precision in what will likely be a very subjective measurement.

Due to our concerns with the lack of comparability and subjectivity, we cannot support the use of a risk adjustment and residual margin. In this light, the Board's language in paragraphs BC 109-110 of the ED appears internally inconsistent. That is, the Board describes the risk adjustment as the amount an insurer would rationally pay to be relieved from risk, but goes on to state that the risk adjustment does not represent the compensation a market participant would require for bearing risk. It is unclear to us *who* an insurer would pay in a hypothetical transaction to relieve itself from risk if the counterparty is not a market participant with a profit motive.

Conceptually we believe if the risk adjustment was reliably estimable and could be calculated consistently between entities, than it would be relevant to have the risk adjustment and residual margin presented separately to provide a view of how entities evaluate the change in risk over time. We prefer the use of a single composite margin, however we also believe that the proposed amortization formula for the composite margin should be studied further to determine if it meets its intended objective.

We are also concerned with the reliability of the proposed risk adjustment calculation, and whether such an approach may imply a false sense of precision in what will likely be a very subjective measurement. We do not understand what is meant by "the maximum amount the insurer would rationally pay to be relieved of the risk". We recommend that the wording in paragraphs B68 and BC105 of the ED be included in the final guidance as it provides some clarity on the objective of the risk adjustment:

"The risk adjustment directly measures the remaining risks in the contracts."

We also recommend that if the risk adjustment is retained, the final guidance include illustrations of how to develop a risk adjustment with different fact patterns. We recommend that the Board engage the IASB Insurance Working Group to help develop this guidance as it is necessary for entities to consistently apply the guidance related to developing a risk adjustment.

**10. Do you think that the risk adjustment margin would be comparable for entities that are exposed to similar risks?**

We believe that the uncertainty surrounding the definition and objective of the risk adjustment margin would make it difficult for entities to produce comparable risk adjustment margins.

**11. Do you agree with the description of cash flows that should be included in the measurement of an insurance contract? Is the proposed guidance operational?**

As noted in our response to Question #7, we recommend that the final guidance clarify that the probability-weighted cash flows is intended to represent an estimate of the mean. We believe that Board did not intend that all outcomes should be identified and a probability weight applied to each outcome in estimate of cash flows.

**12. Do you agree that the carrying amount of all insurance contracts should be discounted if the effect is material? Do you agree with the proposed guidance on the discount rate that should be used to measure the carrying amount of insurance contracts? If not, which discount rate should be used?**

We agree that the inclusion of probability-weighted cash flows adjusted for the time value of money produces relevant information.

We recommend that the Board develop a framework for applying the time value of money, to provide a consistent objective for determining how an appropriate discount rate should be determined as we believe this issue is fundamental and far reaching beyond the insurance project. We are concerned that the required discount rates are inconsistent in several major projects and standards (e.g., insurance contracts, revenue recognition, leases, contingencies, and pensions).

In response to the IASB ED and the DP, we question whether using a risk free rate plus an adjustment for liquidity in a fulfillment model is the appropriate rate to use to discount non-participating insurance contract liabilities. However, we agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability to the extent possible.

We are unclear as to how the liquidity adjustment should be determined. We believe that there should be an adjustment to the risk free rate, but we are unaware of existing theory of the valuation of financial instruments that provides sufficient guidance to assure that such an amount would be consistently determined by different entities.

**13. Do you think that acquisition costs should be included as one of the cash flows relating to the contract? If not, how would you account for acquisition costs?**

We believe that acquisition costs should be included in the cash flows used in the measurement of insurance contracts.

**14. Do you agree that acquisition costs included in the cash flows used in the measurement of the insurance contract should be limited to those that are incremental at the individual contract level? If not, which acquisition costs, if any, would you include in the measurement of the insurance contract?**

We understand the concept and believe it is appropriate to include incremental acquisition costs for contracts issued in the initial measurement of the contract. We note that this accounting is consistent with the guidance in IAS 39 for contracts measured at amortized cost, but acknowledge an inconsistency with the guidance in the proposed Revenue Recognition Exposure Draft.

We also believe that the Board should consider expanding the definition of acquisition costs to be included in cash flows to align it with FASB ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts.

We request clarification on how the following items should be evaluated for inclusion as acquisition costs within the contract cash flows:

- Volume contracts: Would the incremental costs of selling, underwriting and initiating a group of contracts be included in the initial measurement of insurance contract cash flows if those costs cannot be identified at the individual insurance contract level?
- Timing: Would costs incurred prior to the issuance of the contract, for example inspection fee costs, be considered incremental?

**15. Do you agree with the use of either the composite margin approach or two-margin approach to measure the net insurance contract? Does either approach faithfully represent the economics of insurance contracts? Is either approach an improvement over the measurement used in current U.S. GAAP?**

Due to our concerns with the lack of comparability and subjectivity, we cannot support the use of a risk adjustment coupled with a residual margin. Conceptually we believe if the risk adjustment was reliably estimable and could be calculated consistently among entities, than it would be relevant to have the risk adjustment and residual margin presented separately to provide a view of how entities evaluate the change in risk over time. Therefore, we prefer the use of a single composite margin, however we also believe that the subsequent measurement of the composite margin would need to be clarified before it could be properly operationalized.

**16. Do you think that the composite margin should be recognized in earnings in subsequent periods using the ratio described in paragraph 83? If not, how would you recognize the composite margin in earnings?**

A majority of FinREC and the Insurance Expert Panel recommend that the composite margin should offset any increases in the probability-weighted estimate of future cash flows as a “shock absorber”. The remaining composite margin (if any) would be amortized over the remaining coverage plus claim payment period.

We were not able to obtain unanimous agreement on this concept, and recommend that the Board study in greater depth how the composite margin should be released, and also consider whether any type of liability adequacy test should be imposed if the composite margin is used as a shock absorber. When using the composite margin as a shock absorber, the liability would only represent the present value of the mean and some believe that could result in a liability that is not sufficient.

We also note that the ED currently includes no guidance on how the modified approach would work with the composite margin approach during the post-claim period. We recommend that additional information be included as to whether, under the modified model, a composite margin or other additional liability should be determined in the post-claim period, and if it would be released in a similar manner as it would be under the building block approach.

**17. Do you agree that interest should not be accreted on the composite margin? Why or why not?**

We agree. Interest should not be accreted on the composite margin, as it appears to inflate profits and losses by recording interest expense when accreted to the composite margin and profit when it is amortized through the release of the composite margin.

**18. Do you think that all insurance contracts should be recognized and measured using one approach or that some insurance contracts should be recognized and measured using an alternative approach (for example, the modified approach)? Why or why not?**

We believe that entities should have the option of using the modified measurement approach for all contracts if the modified approach results in approximately the same liability in the pre-claim phase of the contract. We believe that the alternative model that we are proposing that uses a revised composite margin as a shock absorber would have substantially the same liability.

If the Board does not adopt our recommendations as discussed in our response to Question #16, we believe that the modified measurement approach will not approximate the Board's proposed building block approach for the majority of contracts. This would restrict the amount of contracts that would be able to apply the proposed modified measurement model.

In that case, we would then recommend that the Board allow entities to have the option of using the modified measurement approach for all short-duration contracts (as defined in U.S. GAAP). We believe that a principle based standard should not include a bright line test (i.e., 12 months) to determine which contracts should apply a measurement approach.

**19. If an alternate approach is required for some insurance contracts, what recognition, measurement, and presentation provisions should be applied (including those items noted in paragraph 106)?**

If an alternate approach is required for some insurance contracts, we recommend that the Board use the short-duration model under current U.S. GAAP, with a modification for incremental acquisition costs net against unearned premium.

**20. Do both the building-block approach and the modified approach (with the latter approach applied only to certain short-duration contracts) produce relevant and decision-useful information? Why or why not?**

Due to our concerns with the lack of a clearly defined objective for the risk adjustment and the questionable cost/benefit of separately measuring this component which may not be capable of being reliably estimated on a consistent basis, we feel that the proposed explicit risk adjustment measurement approach may not produce reliable information for users of an insurer's financial statements, resulting in a complicated model that is not relevant.

Although we prefer the use of a single composite margin, we also believe that the subsequent measurement of the composite margin would need to be clarified before it could be properly operationalized.

**21. How should the scope of insurance products for each approach be defined (for example, duration of coverage period, duration of claims payment period, or type of insurance)?**

We believe that the scope of insurance products for each approach should be defined in a manner similar to the guidance in FASB ASC 944 related to the definition of short-duration and long-duration contracts.

We do not agree with the proposed criteria in the IASB ED requiring entities to use the modified measurement approach based only on the duration of the coverage period, as we believe that a principle based standard should not include a bright line test to determine which contracts should be included.

**22. Are there specific types of insurance contracts for which the approaches would not provide decision-useful information?**

**23. What are the implications of the recent U.S. healthcare reform to the application of the proposed contract boundary principle, including whether health insurance contracts written under the new reforms would meet the conditions in the proposed guidance to be accounted for under the modified approach?**

The application of the proposed contract boundary principle, and criteria to be accounted for under the modified approach could result in contracts that are currently classified as short-duration under U.S. GAAP being reclassified as long-duration under the proposed model.

We believe that the ability to reassess the risk of a policyholder (as discussed in paragraph 46 (b) of the DP) should not require individual contract repricing, if the contracts themselves are only priced on a group basis, and can be repriced for the entire group (for example, health insurance contracts under the new reforms).

**24. What other changes should be considered to both improve and simplify U.S. GAAP for short- and long-duration insurance contracts?**

Please see the cover letter for our full response to this question.

**25. What are the incremental costs of adopting the alternatives described in this Discussion Paper? Please separately describe one-time costs and ongoing costs.**

**Reinsurance**

**26. The scope of the proposed guidance includes reinsurance contracts that an insurer issues or acquires. However, insurance contracts held directly by other policyholders would be excluded from the scope of the proposed guidance. Do you agree with this exclusion? Why or why not?**

**27. Should there be symmetry between the recognition and measurement of reinsurance contracts and the underlying contract ceded?**

The majority of FinREC and the Insurance Expert Panel do not object to the proposed guidance for reinsurance contracts allowing a Day 1 gain by the cedant if the expected present value of future cash inflows plus the risk adjustment exceed the expected present value of future cash flows, as a transfer of risk exists through the reinsurance contract.

However, a minority of FinREC and the Insurance Expert Panel believe that gain recognition upon entering into a reinsurance contract would be inconsistent with the concept in the ED of no Day 1 gain for direct written insurance contracts, and might result in accounting arbitrage. These members reject the idea that risk transfer leads to gain recognition, given that the obligation to the policyholder has not been extinguished nor recognized as an extinguishment for accounting purposes.

We request additional guidance on how the risk adjustment should be calculated for reinsurance contracts, whether it should be on a net or gross basis.

We also believe additional guidance is needed on the scope of contracts subject to the premium allocation approach, specifically as it relates to reinsurance contracts. Specifically, should an entity look through to the underlying insured risk, or to the terms and coverage of the reinsurance contract itself? For example; a reinsurance contract with risk attachment for contracts written in a 12 month period that covers actual claims for a 24 month period; in this situation we are uncertain if this contract would qualify for the modified measurement approach.

**Presentation and Disclosure**

**28. The margin presentation approach highlights the changes in the insurance liability, rather than the current approach in U.S. GAAP, which presents, among other items, premium revenues, benefits paid, operating costs, and changes in loss estimates. Would this change improve your understanding of the performance of an entity that provides insurance (for some types of insurance or for all)? Please explain.**

We believe that certain long-duration contracts would be best presented to highlight risk indicators under a margin approach, while certain short-duration contracts would warrant a traditional insurance presentation to highlight volume indicators.

**29. Should insurance contracts measured under the building-block approach be presented using a margin presentation approach or a premium presentation approach that would require a true-up amount as described in paragraph 119 (for example, the written allocation presentation approach or the allocated premium presentation approach)?**

We believe that the issue of presentation of income and expense arising from insurance contracts is complex, and dependent on the type of insurance product. There are merits to presenting income and expense in either the proposed summarized margin approach or a traditional premiums and claims insurance approach, based on the type of insurance product and whether consideration received for insurance contracts meets the definition of revenue or should be considered a deposit. We believe it is important to have certain of this critical information, such as volume indicators, on the face of the statement of comprehensive income rather than in the footnotes or a supplemental schedule.

**30. Should short- and long-duration (or nonlife and life) contracts be presented in a similar manner even if such contracts are measured under different approaches?**

We believe that different types of contracts (short and long-duration) should be presented in the manner that best captures relevant information for that specific product. Certain long-duration contracts would be best presented to highlight risk indicators, while certain short-duration contracts would warrant a traditional insurance presentation to highlight volume indicators.

**31. Do you agree with the proposed disclosures in the IASB's Exposure Draft? Why or why not? If not, what would you recommend and why?**

The proposed disclosure requirements in the IASB ED include many specific and detailed disclosures that we believe are excessive and will likely obscure the information that financial statement users will find necessary and useful.

#### **Additional Question for Respondents**

**32. After considering your views on the specific issues contained in this Discussion Paper and the IASB's Exposure Draft, what do you think would represent the most appropriate improvement to U.S. GAAP?**

- a. Pursue an approach based on the IASB's Exposure Draft?**
- b. Pursue an approach based on the IASB's Exposure Draft with some changes? Please explain those changes.**
- c. Pursue an approach based on the Board's preliminary views in this Discussion Paper?**
- d. Pursue an approach based on the Board's preliminary views in this Discussion Paper with some changes? Please explain those changes.**
- e. Make targeted changes to address specific concerns about current**

**U.S. GAAP (for example, items included in paragraph 7)? Please describe those changes.**

Please see the cover letter for our full response to this question.