July 17, 2009

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

RE: **Margins for Insurance Contract Liabilities**

Dear Sir David:

The IASB has narrowed its consideration of candidate measurement approaches for insurance contracts to two primary choices (one based on IAS 37 and the other based on contract fulfillment value), although other approaches may be allowed in some circumstances (e.g. an unearned premium measurement approach for certain short duration insurance liabilities; and at least the FASB is considering a candidate that does not include explicit margins or discounting for some insurance liabilities). Both of the primary choices that the IASB is considering are based on the three building blocks of expected cash flows, margins, and discounting; and the differences between these two choices are in the margins building block.

Both of the primary measurement candidate choices under consideration provide for initial margins that are calibrated to no gain at inception. The IASB expects to decide (tentatively) this month whether the margin will be a composite (i.e., the fulfillment value candidate) or a calculated risk margin (and perhaps a calculated service margin) plus a residual margin amount (i.e., the approach aligned with IAS 37).

GNAIE strongly supports the composite margin approach of the fulfillment value candidate that the IASB is considering, which is different than the recommendation from IASB staff in agenda paper 11A for the July IASB and FASB meetings. While it is possible to define methods for calculating risk margins and service margins, we believe that these are theoretical calculations that have little if any practical meaning or basis of calibration. The composite margin information should be more concise and transparent, and should focus on the margin available rather than on theoretical calculations.

In its Discussion Paper "Preliminary Views on Insurance Contracts" (May 2007), the IASB also stated that it "does not intend to prescribe specific techniques for developing risk margins," (Paragraph 86(c) p.55). "Instead, the Board intends to explain the attributes of techniques that will enable risk margins to convey useful information to users about the uncertainty associated with risk margins." Appendix F

Jerry M. de St. Paer
Executive Chair

Douglas Wm. Barnert
Executive Director

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

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

from the Discussion Paper contains a draft discussion of those attributes. One of the attributes of risk margins that is described in Appendix F (in sub-paragraph F3(i)) is that if more than one approach is compatible with the criteria, it is preferable to select an approach that builds on models that the insurer uses to run its business. GNAIE believes that insurers should not be prevented from using a composite margin approach in their financial reporting if such an approach builds on models that insurers use to run their businesses.

GNAIE strongly agrees that the accounting standard should not prescribe specific techniques for developing risk margins. Whichever choice the IASB makes regarding the measurement approach, GNAIE believes that the accounting standard should allow techniques for accounting for the actual margins to be based on emerging accounting and actuarial professional standards. The International Actuarial Association has done a considerable amount of work on identifying acceptable ranges of such techniques; and GNAIE expects that the techniques will continue to evolve and improve over time.

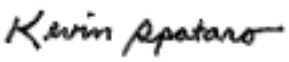
GNAIE suggests the following attributes of margins for consideration in an accounting standard for insurance contracts, and that professional actuarial standards should be the basis for the techniques that are used to determine the actual margins. The two attachments to this letter contain examples of how margins could be determined consistent with the attributes listed below. Appendices 1 and clarify how GNAIE believes that margins should be determined for non-life and life insurance contracts respectively.

1) The initial margin is calibrated to no gain at inception, subject to testing for initial loss recoverability.
2) The accounting standard should not specify how this margin is calculated. The margin may be added to cash flow estimates, incorporated in the discount rate used or applied to the liability as a whole, so long as it meets the other requirements set out below.
3) The accounting standard should not specify the pattern for how the margin is released over time. Margins are to be released over the duration of the insurance contract as the insurer is released from risk, which will generally result in a pattern of reducing margins over the life of the contract, reducing to zero at the end of the contract period. However, for contracts where the liability increases over time, the margins might increase during those periods.
4) New information that becomes available after the contract is issued should be considered in the insurer's decisions on whether to change the amount of margins or the patterns for releasing those margins; but it is up to the insurer to determine when the new information is material and whether/how it is applied in updating the margin. (E.g, if interest rates should fall to very low levels, retaining a large margin in the discount rate might not make sense.)
5) Except when a margin becomes unreasonable, a company will not change the method for calculating the margin simply because another assumption is changed (i.e. the margin should not be a "shock absorber"). For example, if the margin is set at 20% of the assumed mortality, and the mortality assumption increases by 10%, the margin should not be reduced from 20% to 10% to offset the increase in assumed mortality.
6) If more than one approach is compatible with these criteria, it is preferable to select an approach that builds on models that the insurer uses to run its business.
7) The insurer should disclose basic parameters for how it has calculated margins and for how the margin is released.

As always, we appreciate your attention and consideration of our views, and we look forward to working with you to bring this project to a successful conclusion. Please see the appendices following for a detailed description of the application to the non-life and life business lines:

Appendix 1 is headed "Margins – Non-life Insurance Contracts"
Appendix 2 is headed "Margins - Life Insurance Contracts"

Sincerely,



Kevin A. Spataro
Chairman, GNAIE Accounting Convergence Committee

CC: IASB, Peter Clark, Hans van der Veen, Mark Trench, Jeffery Cropsey, Mark Siegel, Leslie Seidman

APPENDIX I

Margins – Non-life Insurance Contracts

Similar to our position on the accounting for margins in Life insurance contracts, GNAIE supports the concept of a composite margin for Non-life insurance contracts ("NLIC's"). The mechanics of how the margin for NLIC's is earned, however, does differ from the mechanics associated with Life insurance contracts consistent with the fundamental differences in our Life and Non-life measurement models. Following is a summary of the key attributes of GNAIE's measurement model for NLIC's that provides a description of how margins are measured, earned, and reported.

- The key attributes of GNAIE's measurement model for NLIC's are as follows:
  - Premiums received from customers recorded as unearned premium ("UPR") when received;
  - UPR is typically earned on a pro-rata basis over the period insurance protection services are provided (typically one year or less for NLIC's);
  - UPR is not discounted and is not decomposed into components such as an expected profit, risk, and service margin;
    - Similar to GNAIE's views on Life insurance; our view for NLIC's is that a decomposition of margins such as profit, risk, and service would simply result in a mathematical exercise that would not provide useful information to financial statements users, would not be verifiable, and would decrease comparability amongst insurers.
  - For each reporting period a NLIC remains in force and provides insurance protection, a portion of UPR is earned and against that revenue is an allocation of expenses and an estimate of incurred losses (both reported and not reported).
  - The key performance measure for Non-life insurers is Underwriting Income ("UI") which is comprised of premiums earned during the reporting period less expenses and losses. Investment income, which is considered an ancillary income stream is not included in UI.
  - The total income attributable to a NLIC is earned over the coverage period (i.e., the period over which insurance protection services are provided).
  - At the end of the coverage period unpaid claims are fully provided for in claims reserves;
  - In future periods, necessary adjustments to claim reserves (increases or decreases) are recognized in income as negative or positive reserve development in the period identified;

EXAMPLE

- One year homeowners policy with a $1,200 premium;
- On day 1 insurer records UPR as $1,200
- On day 1 insurer expects loss ratio to be 65% and expenses to be 25% of premium;
- Each month, insurer "earns" $100 of premium as insurance protection is provided over coverage period;
- Each reporting period UI is constructed as the key performance measure which begins with premiums earned during the reporting period and that amount is reduced by expenses determined on an accrual basis and losses on an incurred basis;
- At the end of year 1, assuming assumptions hold, insurer has recognized income of $1,200; expenses of $300 (including commissions), losses of $780, and UI of $120;
- Assuming all losses are not reported and paid at the end of year 1, a portion of the $780 will remain as a reserve and will be subject to future adjustments;
- Where actual experience diverges from original expectations during the coverage period, the change in accounting and reporting results is illustrated by the following example. If expenses are $320 as opposed to $300 and losses are $800 as opposed to $780 – UI would decline to $80 for the annual period and claim reserves would increase by $20 assuming the loss is not paid by that time.
- If the preceding loss adjustment is not identified until after the end of the coverage period the adjustment would still impact UI (as a negative reserve development) in the period identified;
- GNAIE does not believe recognition of the $120 should occur over any period other than the coverage period – the period over which risk protection services are provided;
- GNAIE does not believe decomposition of the $120 into sub-margins such as risk, service, and profit margins would be meaningful or useful to financial statement users as the distinction would be purely theoretical and mathematical and would not be objectively verifiable against market-based measures nor would it lead to greater comparability or understandability.
- GNAIE believes any decomposition would take a relatively simple and well understood model and make it complicated and difficult to understand; which is diametrically opposed to the goal of the Insurance Contracts Project.

APPENDIX 2

Margins – Life Insurance Contracts

GNAIE supports a composite margin for Life Insurance contracts, calibrated to no gain at inception. There are a number of approaches by which such a margin can be released. We believe that the appropriate professionals should develop guidance for the release of composite margins. But in this Appendix, we illustrate one possible approach in which the margin is released in proportion to the remaining expected claims.

In the first example, we assume a 5 year life insurance product. Premiums are assumed to be 1000 per year, maintenance expenses are assumed to be 50 per year and there are 750 of incremental acquisition costs at inception. Claims are assumed to be 300 in year 1, 600 in year 2, 800 in year 3, 1000 in year 4 and 1200 in year 5. For simplicity, we assume that the liability discount rate and the asset yield are both 0%. Premiums are assumed to be received at the beginning of each year, and claims and maintenance expenses are assumed to be incurred at the end of each year.

We solve for the composite margin at issue so that there is no gain at inception. For purposes of the example, we follow the IASB preliminary view and define a gain at inception after recognizing incremental acquisition costs. At inception, 1000 of premium is received and 750 of incremental acquisition costs are incurred, so the initial liability needs to be 250 to result in no gain or loss at inception of the contract. It does not appear that this contract is onerous at inception, so an initial liability of more than 250 is not needed. Without margins, the present value of future claims and expenses to be incurred net of the present value of future premiums to be received produces a liability of 150. So a margin of 100 is needed at inception to achieve a liability of 250. On a present value basis, a margin of 100 at inception is equivalent 2.6% of the present value at inception of the expected claims.

In this example, the margin decreases as the present value of future claims decreases. At the end of the first year, the margin has declined to 92. By the end of the 4^{th} year, the margin is down to 31. We believe this approach produces a rational pattern of margins, liabilities and earnings. However, it is not the only approach that might be used. Professional standards may allow for a range of acceptable approaches (e.g., margin might be allocated a portion of claims, expenses, discount rates, unit inforce, or even some combination).

Although we disagree with FASB's preliminary view on the treatment of acquisition costs, that view would not inhibit the use of this approach to calculating and amortizing a composite margin. The second example shows the same example using FASB's preliminary view on acquisition costs. In that case, the initial liability must be equal to the initial premium of 1000. That produces an initial composite margin of 850, or 21.8% of claims. Although we believe that the resulting liability and earnings pattern does not reasonably reflect economic results for the contract in this example, it appears to us that the problem is a result of the treatment of acquisition costs and not due to the calculation or amortization of the resulting composite margin.

Example of Life Insurance Margin using IASB Preliminary View on Acquisition Expenses:

		1	2	3	4	5	Total
Premium		1,000	1,000	1,000	1,000	1,000	5,000
Investment Income		0	0	0	0	0	0
Claims		300	600	800	1,000	1,200	3,900
Maintenance Expenses		50	50	50	50	50	250
Incremental Acquisition Expense		750					750
Increase (Decrease) in Liability		(108)	335	129	(76)	(281)	0
Net Earnings		8	15	21	26	31	100
Discount Rate / Investment Yield	0%	-					

	Inception	1	2	3	4	5
Liability (Asset) Excluding Margin	150	(200)	150	300	250	*0*
Margin	100	92	77	56	31	*0*
Liability (Asset) End of Year	250	(108)	227	356	281	*0*
Margin as percent of present value of future claims	2.6%	2.6%	2.6%	2.6%	2.6%	

Example of Life Insurance Margin using FASB Preliminary View on Acquisition Expenses:

		1	2	3	4	5	Total
Premium		1,000	1,000	1,000	1,000	1,000	5,000
Investment Income		0	0	0	0	0	0
Claims		300	600	800	1,000	1,200	3,900
Maintenance Expenses		50	50	50	50	50	250
Incremental Acquisition Expense		750					750
Increase (Decrease) in Liability		585	219	(24)	(268)	(512)	0
Net Earnings		(685)	131	174	218	262	100
Discount Rate / Investment Yield	0%	-					

	Inception	1	2	3	4	5
Liability (Asset) Excluding Margin	150	(200)	150	300	250	*0*
Margin	850	785	654	479	262	*0*
Liability (Asset) End of Year	1,000	585	804	779	512	*0*
Margin as percent of present value of future claims	21.8%	21.8%	21.8%	21.8%	21.8%	