



September 15, 2009

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

Dear Sir David:

The Group of North American Insurance Enterprises (GNAIE) has reviewed and discussed Staff Papers 17C (**Subsequent release of residual and composite margins**) and 17D (**Discounting Insurance Contracts**) for the September IASB meeting, and we are pleased to share our comments with you. Unless otherwise noted in this letter, our comments describe GNAIE's views for life insurance contracts.

Comments on Staff Paper 17C (Subsequent release of residual and composite margins)

For all insurance contracts, GNAIE believes that the essential right that the policyholder purchases and obligation that the insurer assumes is payment of benefits according to the contract terms if an insured event occurs during the coverage period. In all cases, GNAIE believes that margins, if there are any in the liability measurement, should be released over the coverage period, and that the revenue for the contract should be recognized over that same period.

Insurers do other work in support of meeting their basic obligation to provide coverage. There are administrative functions, such as underwriting and issuing policies, collecting premiums, making requested policy changes, and maintaining policy records. The distribution and significance of other work in support of providing insurance coverage varies by the type of insurance. For example, investment management is significant for some kinds of life insurance; and claim settlement is particularly significant for many kinds of non-life insurance.

The coverage period for most non-life insurance contracts is short (typically one year); but claim settlements for such coverage may extend over many years. In some cases, claims are reported and settled many years after the insurer believes that it has settled all of the claims for a particular coverage year. In such cases, assigning revenue, or margins if there are any, to the supposed claim settlement period is particularly speculative and unreliable.

With these comments as background, GNAIE has the following responses to the questions for the Boards on pages 8 and 11 of Staff Paper 17C.

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Question for the Boards on p.8. Which approach should the boards select for release of residual and composite margins?

- (a) The boards should not prescribe particular drivers; rather, the insurer should select driver(s) that result(s) in recognizing that margin in income in a systematic way that best depicts the insurer's performance under the contract.**
- (b) An insurer should use release from risk as the driver in all cases.**

As noted below, GNAIE believes that revenue should be recognized over the period of time that the insurance policy provides insurance coverage. We therefore believe that alternative b) is the more reasonable general approach to use. In implementing alternative b), however, we suggest that alternative a) is a more reasonable way to describe the implementation (i.e., the insurer should select driver(s) that result(s) in recognizing that margin in income in a systematic way that best depicts the insurer's performance under the contract).

Question for the Boards on p. 11. What period should be used for release of the residual and composite margins?

For both life and non-life contracts, GNAIE believes that the residual and composite margins, if there are any, should be released as the insurer is released from risk over the coverage period. Contrary to the recommendation in Paragraph 28 of the Staff Paper, we do not believe that this conclusion should depend on whether or not there is a separate risk margin.

The insurer may settle claims that occurred during the coverage period after the end of that period (in some cases, many years after the end of that period). As of the end of the coverage period, the insurer will have established a liability for claims that have been incurred but not yet settled (including a liability for claims that have been incurred but not yet reported), based on all relevant available information. After the end of the coverage period, the insurer will update the estimated remaining liability as claims are settled and as new information becomes available. In general, however, these changes are only improvements to estimates, which continue to be estimates until the claims are settled. They do not represent any change in the risk insured.

GNAIE also has the following comments on the other two questions for the boards in Staff Paper 17C.

Question for the FASB on p.5. Do you agree that a day-one, if any, loss should be recognized in profit or loss?

GNAIE agrees that a day-one loss, if any, should be recognized in profit or loss. However, we would expect that such a loss should only occur if, at the time of issue, the insurer does not expect to earn a profit over the lifetime of the policy, or if the insurer discovers prior to issue that it made an error in pricing or underwriting the policy to the extent that a loss is expected. Normally, a loss should not be recognized at issue for a policy on which a profit is expected over its lifetime.

Question for the Boards on p.14. Which approach (Approach A or B) should be applied when there are changes in estimates?

- (a) **If the boards believe that a current measurement is integral to understanding and reporting insurance contracts, they should select an approach that reports all changes in estimates in profit or loss (or other comprehensive income) (Approach A).**
- (b) **If the boards believe that the guidance in revenue recognition is integral to all components of the insurance liability, then they should select an approach that recognizes changes in estimates of financial market variables in profit or loss (or other comprehensive income, a subject for future discussion) but adjusts the remaining residual or composite margin (if any) for all other changes in estimates, provided that this margin does not become negative (Approach B).**

GNAIE believes that many key aspects of the customer consideration approach, on which the IASB and FASB have tentatively agreed in the revenue recognition project, are appropriate for insurance contracts. However, in situations where there is a residual or composite margin for insurance contracts, we believe that it would be most decision-useful to release those margins as the insurer is released from risk over the coverage period, as described above; and to report all changes in estimates in profit or loss (or Other Comprehensive Income (OCI)).

The one exception to this position would be with regard to treatment of investment components, most particularly the discount rate. Specifically, we believe that changes in the discount rate should reflect changes in asset values, and the accounting for such changes should be consistent with treatment of changes in asset value. For instance, if the assets supporting the liabilities are measured at fair value with unrealized changes going through OCI, we suggest that changes in the liability due to those unrealized changes should also go through OCI.

If the assets supporting the liabilities are held at amortized cost, then all changes in the liability due to changes in the discount rate should go through OCI.

Comments on Staff Paper 17D (Discounting Insurance Contracts)

- 1) The recommended objective in Staff Paper 17D is a discount rate that reflects characteristics of the liability and that should not capture characteristics of the assets held to back those liabilities (unless those liabilities share characteristics of the assets as described in more detail below). The extent to which we agree (or don't agree) with this recommended objective depends on how certain terms are interpreted.
 - a) According to Paragraph 13 of the Staff Paper, the recommended objective is based on a view "that cash flows from assets backing an insurance liability are irrelevant for a decision-useful measurement of that liability (unless the cash flows from those assets *affect (emphasis added)* the cash flows arising from the liability)". GNAIE believes that such an effect exists for the vast majority of liabilities for life insurance contracts including contracts that provide for non-guaranteed interest crediting rates, such as universal life and many annuity contracts, as well as for participating whole life contracts (which we understand are scheduled to be discussed by the Boards at future meetings). Such effects (of cash flows from assets on cash flows for liabilities) are critical features in many insurance contracts, and in how such contracts are priced (since the contract price of the product reflects expected returns on subsequent premiums) and managed.
 - b) We agree that the appropriate discount rate should include a premium that reflects the liquidity characteristics of insurance obligations; but we are concerned that those characteristics are not

sufficiently recognized in the Staff Paper. For example, Paragraph 20 contains the statement that “For those insurance liabilities for which cash flows can occur at any time without advance warning, the discount rate will probably be close, or perhaps identical to, the risk-free rate of highly liquid instruments, such as government bonds”. It is important to remember that insurers manage liabilities on a portfolio basis, with policyholder behavior taken into consideration. Cash flows for many life insurance liabilities can occur at any time during the contract period, but they are either dependent on occurrence of an insurable event (e.g., death) or exercise of an option by the policyholder that often involves a financial adjustment (e.g., a surrender, requiring a surrender charge or a market value adjustment), which will only occur for a portion of each portfolio of contracts at any time. We believe that a liquidity adjustment is needed to reflect such circumstances. Life insurers evaluate their experience and various scenarios to determine potential liquidity needs, and we believe that a liquidity or other adjustment in the discount rate should also be based on these circumstances.

- 2) In general, GNAIE believes that a principles-based approach should be applied with respect to discount rates, supplemented by disclosure about what the rates are and how they were determined. Such disclosure will help provide transparency and will enable users of financial statements to compare results among entities. Appropriate professional actuarial organizations are in a good position to provide guidance on acceptable ways to determine discount rates.
 - a) While we advocate a principles-based approach in the accounting standard, we believe that the principles should accommodate practical alternatives such as those described in Paragraph 23 of the Staff Paper. Of the options that are listed in Paragraph 23 for such practical alternatives, we believe that option a) (market observable rates for high-quality corporate bonds) would be the most appropriate starting point from which to make the adjustments described in the Staff Paper.
 - b) Furthermore, we believe that a principles-based approach should be used in describing when and how to adjust the base rate, such as for liquidity. In 1)b) above, we describe several circumstances in which adjustment to the discount rate could be justified. The current variety of life insurance contracts in the world is wide, and it is expanding. The principles should be sufficiently flexible to allow for adjustments to the discount rate that are appropriate for types of insurance contracts that now exist, and hopefully for new types of insurance contracts that will be developed.
- 3) We remain concerned about the potential for significant day one reported losses on insurance contracts that are reasonably expected to be profitable, because of differences between discount rates used in pricing such contracts and in accounting for the contract liabilities (the problem described in Paragraph 28 of the Staff Paper), as well as the potential for “day 2 and after” mismatches in the measurement of assets and liabilities. We strongly encourage the Boards and their staffs to investigate this point further through field testing, especially for long duration insurance contracts. Whether the approach to discount rates in the accounting standard adequately addresses these concerns depends on how the points covered in this letter are addressed and interpreted, especially the need to adjust the discount rate for a wide variety of circumstances based on the nature of a variety of insurance contracts (as described in 1)b) and 2)b) above).
- 4) Finally, it is our belief that requiring a risk free discount rate without adjustment would lead to unrepresentative and unacceptable results for insurance liabilities. We discussed the shortcomings of



the use of the risk-free rate in our letter to the IASB dated June 25, 2008, attached for your convenience.

We hope these comments are useful and we would be happy to elaborate on them.

Sincerely,

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

Kevin Spataro
Chairman, Accounting Convergence Committee
kk:wes

CC: Mr. Robert H. Herz, Chairman, FASB
FASB Members/IASB Members
Mr. Has van DerVeen, Practice Fellow, IASB
Mr. Jeffrey Cropsey, Project Manager, FASB