



May 30, 2008

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Dear Ms. Martin:

The American Council of Life Insurers (ACLI) and the Group of North American Insurance Enterprises (GNAIE) appreciate the opportunity to offer our views on the 24 March 2008 Re-Exposure Draft-*Measurement of Liabilities for Insurance Contracts: Current Estimates and Risk Margins* (ED). ACLI is the principal trade association of life insurers, representing 353 members that account for, in the aggregate, 93 percent of the total assets, 93 percent of the life insurance premiums, and 94 percent of annuity considerations in the United States. Our members operating in international markets represent virtually all North American life insurance, life reinsurance and retirement security providers with a global presence. GNAIE consists of Chief Financial Officers of leading insurance companies including life insurers, property and casualty insurers, and reinsurers. GNAIE members include companies who are the largest global providers of insurance and substantial multi-national corporations.

Note that this letter addresses the ED as it applies to life insurance contract liabilities and not as it applies to liabilities for non-life insurance contracts.

We applaud the effort of the IAA in the preparation of this ED. This is a necessary and instructive document that should assist standard setters and regulators in the development of high quality standards for accounting and solvency. Our comments, representing the views of the life insurance industry, are presented below in the following sections similar in format to our response to the original draft document: [General Comments](#); [Responses to Specific Questions](#); and [Summary](#).

#### General Comments

We believe this ED can serve as a critical discussion document in the development of a high quality global accounting standard for the measurement of life insurance contract liabilities. It provides a comprehensive overview of the various methods and approaches to measurement, which should be helpful to standard setters and the actuarial profession as they try to understand how these methods and approaches could be applied in a real world setting. While the ED offers some recommendations about various aspects of the measurement of insurance contract liabilities, more could be done in this regard. For example, the ED focuses on the issues that would impact the three building blocks. While we support the concept of the three building blocks for life insurance contracts, one other area that the IAA could contribute to the Project is to critique the description of the building blocks, for example, should the first building block be described in detail as the “explicit,

unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows” or a more broadly based statement?

As the IASB develops a principles-based approach to the standard, we question whether the standard should be prescriptive about such things as “probability-weighted”, discount rate or market-based assumptions. The ED does not identify a single method or approach as the right answer but instead recognizes that each method has its advantages and disadvantages. Consequently, an IAA position expressing the view that there is no “silver bullet” and that companies should use the most relevant and reliable method based upon their lines of business would be consistent with a principles-based standard. Key to this view would be the development of sufficient actuarial guidance to assist the actuaries in selecting the most appropriate method that produces information that is useful and comparable to the users of the financial information.

The ED’s presentation about risk margin characteristics, purpose and methods was especially instructive. We support the position that the measurement objective should include an explicit margin for bearing risk for life insurance contract liabilities. The analysis in Section 6 about the four methods, (1) Quantile, (2) Cost of Capital, (3) Discount related and (4) Explicit assumptions, would indicate that each method has merit. While the IAA notes that the Cost of Capital may be a “theoretically sound method,” it can be difficult to calculate in some cases and the alternatives could provide a reasonable measure. We believe more research and possible field testing of the various methods applied to the major lines of business is necessary. Each method should be tested with respect to the cost and effort needed to implement and sustain each method. The paper identifies a “no gain at issue” principle as a prescription regarding the cash flows considered in measuring the contract. Some greater discussion of this principle in the context of the risk margin is also in order.

Section 4 of the ED provides commentary about the current estimates as part of the measurement of insurance liabilities. It includes a list of criteria or characteristics that may be useful in determining non-market based inputs in the development of a current estimate, which we find to be comprehensive. While this Section makes note of possible constraints that might be imposed by the accounting standard, we believe the IAA should expand the analysis and assess how certain constraints affect the measurement. One example would be to compare and contrast the outcome of “exit value” as envisioned in a fair value model vs. one based upon the expected payments of the obligation as they come due. Another example would be to assess the outcome of the measurement with and without renewal premiums included in the measurement especially for life insurance contract.

#### Responses to Specific Questions

We remind the reader that our responses in this section are intended to address the issues as they pertain to life insurance contract liabilities.

**Question 1. In Section 4, key considerations for determining expected cash flows are described.**

**(a) Do you disagree with the description of any of [the considerations for determining expected cash flows]? Should any be left out or modified, or others added?**

We have no objection with any of the descriptions used. We believe that this chapter could be profitably streamlined by omitting or shortening some of the considerations that could be considered self-evident. For example, any product with a guarantee will have an asymmetric set of projected cash flows. And approximations of some sort are used in virtually every life

insurance valuation and are almost always acceptable unless there are materiality considerations. It would seem that several portions of Section 4 could be omitted or significantly edited. In its place more comparative analysis would be helpful to standard setters and preparers as noted above.

**(b) In Section 4.3.1, reference is made to the relevance of the financial reporting context to the measurement and possible limitations and constraints that may be placed on the estimates. Do you believe this paper should discuss potential restrictions on current estimates or risk margins as is done in the current version of the paper or should this discussion be made in another research paper when more is known about the direction of specific constraints, e.g. later in the IASB Phase 2 project? If you believe this paper should address these issues, please indicate the specific constraints that you believe should be addressed, and whether they should be discussed more extensively.**

We believe that the current draft adequately addresses this possibility and no additional commentary is needed.

**(c) Do you agree or disagree with the distinction provided in the selection of market based or non-market based assumptions? Why?**

We agree with the distinction as described. We agree that relevant market-based inputs are most likely to be financial or economic assumptions, and question the relevance to users (both analysts and regulators) of attempting to estimate other “market-consistent” inputs to the current estimate. We think the IAA’s use of the phrase “portfolio-specific” is slightly clearer than the phrase “entity-specific,” which is used in U.S. GAAP, but the definitions are substantively the same.

**(d) Are there other aspects of expected cash flows that should be addressed?**

No.

**Question 2. In Section 5, discounting is discussed.**

**(a) In Section 5.2 risk-free discount rates are discussed. Should these be the basis of discounting? If not, what should they be based on? Several approaches to determining risk-free rates are described – if risk-free rates are used, what should their basis be (e.g. spot rates, swap rates) and why?**

While the ED provides ample description of various approaches it lacks any analysis of the impact the various approaches might have on the measurement and the interrelationship with risk margins, which we believe is critical before making a decision about the discount rate.

**(b) A discussion of liquidity is included in section 5.3. Should this be a factor to consider in the measurement of liabilities and/or should it be included in the final version of this paper? If it should be included, is the discussion appropriate or do you have recommended modifications?**

As noted near the end of the Section, “it could be argued that a liquidity premium might be justifiable for liability cash flows with a very high degree of predictability...”. Therefore, one would expect that in certain cases liquidity should be factored into the measurement. However, we believe that liquidity premium should not be overemphasized since it might be viewed as a liquidation approach to measurement. This is an example where a principles-based standard should not be so prescriptive and the implementation guidance should

contain illustrations where liquidity should be taken into account. Consequently, we believe this Section should be included in the final version.

- (c) For cash flows that are not directly related (but are generally affected by the asset investment performance) to a designated set of assets (such as universal life or many, but not all, participating contracts for which competition also can play a role), should discount rates be based on the actual assets held or on a market-based set of yield rates or some other alternative?**

Whether the discount rate should be based on the actual assets cannot be answered without a complete analysis of the effects of including or excluding the return of the actual assets held. In addition, the interrelationship of the discount rate and risk margin under these scenarios is also required. We believe this is one of the critical outstanding issues that must be resolved before a final accounting standard can be achieved.

- (d) For cash flows that are linked to the performance of a set of designated assets (e.g., certain participating or unit-linked/variable contracts), should the discount rate(s) be based on the expected performance of those assets or another basis?**

See our response to ( c ).

- (e) Do you believe that guidance is needed to develop market-consistent assumptions and why? If yes, who do you believe should provided it (e.g., regulator, the IAA, the IASB, the local actuarial association or regulator) and what form of guidance is needed?**

Some principle that announces the objective when determining the discount is necessary for consistency, beyond that the need for additional guidance will depend on whether that principle refers to the entity's experience or to some "objective" discount rate. There may be a particular need for guidance in determining a market consistent asset return rate. In order to remain flexible enough to apply in the broad range of insurance markets, the IASB should state the broadest possible objective and allow regulators and professional standards to determine the details and application of the principle, consistent with sophistication of the local markets and the nature of the products being valued.

**Question 3. In Section 6, risk margins are discussed.**

- (a) In 6.1, several possible objectives of risk margins are described. Do you believe that this discussion is reasonable? If not, what do you believe the objective of risk margins should be?**

We believe the Section sufficiently describes the objectives of risk margins. We support the view that the objective of risk margins is a provision for the cost of bearing risk (not a shock absorber).

- (b) Possible approaches to the quantification and qualification of risk margins are discussed in the remainder of Section 6.**

- (i) Are the desirable risk margin characteristics appropriately described?**
- (ii) Are the identified pros/cons of methods reasonably presented? If they are not, please describe those that you disagree with.**
- (iii) Should the IAA put forth a proposal for one or more preferred methods for the quantification of risk margins? If so, which method(s) should be recommended and should this be included in the final version of this paper or another work product?**

The Section sufficiently describes the various methods and the pros/cons of each. We do not support identifying a single preferred method. Rather, guidance should be developed that illustrates which method(s) would be acceptable for each line of business producing a reliable and cost effective approach that provides useful and comparable information to the user community.

**(c) Practical issues of risk margin calculation methods are discussed. Are these issues appropriately identified and described?**

We believe that Section 6.10 adequately describes the practical issues. However, the paper could be enhanced by developing the advantages and disadvantages of calibrating the margins to the premiums in the contract.

**(d) Is the use of a reference entity or portfolio appropriate?**

- (i) If so, what should the characteristics of the reference entity or portfolio be? If so, in what context should they be provided (e.g., in accounting standards, actuarial standards, by the regulator or developed by emerging practice)?**
- (ii) If not, why?**

Our recommendation is that the use of the entity's own portfolio is the appropriate approach, which better reflects the nature of the business and one that would provide useful information about the entity's performance. A reference entity approach, besides being a hypothetical view, would likely be difficult to develop and rules based that is counter to a principles-based approach.

**(e) Should the size (with respect to process or random deviation uncertainty risk), diversification or other feature of the portfolio or entity be considered in the determination of risk margins? If so, what should the level be that they should be considered – the portfolio or the entity? And if so, why should it be?**

**(f) Do you agree with the assessment and comparisons included in Section 6.11?**

**Question 4. Section 7 deals with risk mitigation approaches.**

**(a) Do you disagree with the treatment of any of the approaches indicated? If so, please provide your preferred approach?**

While we believe Section 7 provides adequate discussion of the various risk mitigation techniques, what is ultimately needed is a principle that articulates the role of risk mitigation in the measurement of contract liabilities vs. the amount of capital necessary for the enterprise. We do not support a single approach be used for all products in all cases. Rather, management should decide the best method to be used given the nature of their business and the risk characteristics of the products with sufficient disclosures about the methods used and the effects on the measurement of the liabilities.

**(b) Do you believe that diversification should be reflected in the measurement of liabilities (either within a portfolio or inter-portfolio)? Why or why not? Are the approaches given in Section 7 regarding diversification or in Appendix C appropriate? If not, do you have any suggestions as to how the effect of diversification should be measured?**

The concept of diversification should be taken into account in the measurement of contract liabilities. Fundamental to the nature of insurance is "pooling" of similar risk characteristics. As noted in 7.1, we support the view that similar-sized pools of similar obligations with similar risk profiles would result in similar liabilities.

Likewise, the measurement of reinsurance should be consistent with the measurement of the contract liabilities as if it were directly written. This view should not be interpreted to mean there is “mirror imaging”, i.e., the credit taken by the ceding company is not identical to the amount reported by the assuming company. Each company would use all relevant inputs in the measurement. The results should be similar but not identical.

**Question 6. Are the appendices included useful and sufficient for the purpose indicated? If one or more are not, please indicate which and why.**

The overall purpose of the paper as stated in the cover letter is to “provide the results of research and discussion related to actuarial measurement of liabilities of insurance contracts as they relate to regulatory and general purpose accounting on an international level.” With that stated purpose, the appendices provide the reader with useful background information and additional insight into the thinking that went into the conclusion reached with the paper. The audience of the paper appears to be company actuarial professionals and is therefore somewhat highly technical and detailed in nature. Appendices A-D are specific to Section 6 of the paper dealing with measurement methods. Below are comments specific to each appendix.

Appendix A – Statistical Background, Product Assumptions and Risk Distributions Considered for Risk Margins for Different Time Horizons. This appendix is very detailed and mathematical oriented, reads much like a text book and is heavy on statistics. This appendix’s primary use would be to the actuaries who are the primary audience of the Risk Margin’s Working Group paper.

Appendix B – Life Insurance and Annuity Risk Margin Examples. Similar to Appendix A, this appendix is very detailed and mathematical oriented. The appendix should clarify that this is only an example and actual practice may differ depending upon the complexities of the product being modeled and the individual company.

Appendix C – Diversification. This appendix contains good insight and was high level enough to be easily understood. It provides a brief explanation of how the ordering of risk was determined to enable the reader to better understand the logic and accuracy of risk types is in Table C.2. The note at the bottom of the table refers to percentages listed below when the table is above.

Appendix D – Current Estimate Assumptions. This appendix contains a general discussion regarding current assumptions that are used in the calculation of insurance liabilities. The audience seems to be general user/reader, as opposed to an actuary involved in the reserve setting process. At times the comments seem to be a bit anecdotal. While this appendix is good to have, we do not feel that it is necessary. We believe it may be helpful to separate the property & casualty specific discussion into a separate appendix.

Appendix E – The IAA ad hoc Risk Margin Working Group Background. This appendix addresses the background of the IAA’s ad hoc Risk Margin Working Group and the process it has followed to develop the paper. It is good information to have as a reference for use in reviewing the paper and helps put the paper in the proper context for the reader.

**Question 7. Appendix D indicates that the operating expenses of a portfolio or the entity should be used rather than market-based expenses. Which basis for determination of expenses do you believe would be appropriate to be used? Should it vary depending on the**

**application? If market-based expenses should be used, what approach(es) should be considered for use in determining them? Should the size of the entity or portfolio matter?**

We agree that the expected value of future cash flows should reflect the operating expenses that the reporting entity expects to incur, rather than market-based expenses.

Entity-specific expense assumptions provide the most reliable and relevant representation of the costs that the insurer is likely to incur in administering the contract. Because entity-specific expenses provide an indication of the levels to which a company intends to manage its expenses, performance reporting based on entity-specific expenses will provide the most useful information to analysts and investors. Service levels, claim settlement practices, and other relevant characteristics can vary widely from one company to another. Therefore, using a market-based expense assumption – rather than the costs that the reporting entity expects to incur – is likely to produce illogical results that are not decision-useful. Consider the example of an insurer that incurs higher servicing costs than other market participants. If the insurer were required to value its liabilities using the expense assumptions that a hypothetical market participant would use, this could result in a gain at issue, because the premium would provide for a higher expense than the market would suggest. However, losses would emerge in subsequent years, as the actual expenses exceed those assumed in the liability calculation. Conversely, an insurer whose expenses are lower than other market participants may be required to report a loss at issue, followed by gains in subsequent years. This pattern of gains and losses does not reflect the economic reality of the transaction.

Furthermore, insurer expense levels are not directly observable in the market. Therefore, the determination of a “market consistent” expense level is subjective and open to potential manipulation. Although the IASB Discussion Paper on Insurance Contracts proposes the use of market-consistent assumptions, the paper acknowledges that “in practice, the Board expects that an insurer would use estimates of its own servicing costs, unless there is clear evidence that the insurer is significantly more or less efficient than other market participants” (¶ 62). We feel that it is potentially misleading to describe expense assumptions as “market consistent” when they are, in fact, based on the insurer’s estimates of its own servicing costs. Therefore, we feel that it would be more appropriate for accounting standards, solvency standards, and other guidance to prescribe the use of entity-specific expense assumptions.

**Question 11. The possibility of including a risk margin in the measurement of the liability for post-retirement benefits, including pensions has recently been discussed. Do you believe that this would be appropriate? Please explain the reason for your response?**

Given the limited context for this question, we believe it is premature to comment on this specific aspect of the valuation of a post-retirement liability until we have had an opportunity to review the recently released IASB Discussion Paper: Preliminary Views on Amendments to IAS 19 Employee Benefits.

## Summary

While we believe the final report will be of significant value to standard setters and regulators, there are sections of the report that can be reduced or eliminated while other areas could be expanded as noted in our responses to the questions. Our recommendation is that the IAA provides more analysis in the area of discounting and the interrelationship with

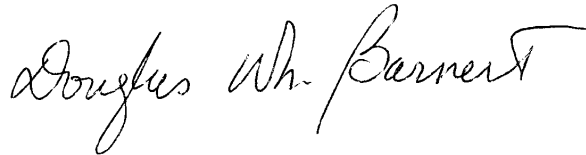
risk margins. This is a critical issue that needs more work. In addition, the IAA should expand its work on policyholder behavior as it relates to renewal premiums especially for life contracts and an analysis of an alternative measurement attribute that is based upon the expected payments of the obligation as they come due. Finally, testing the various methods and approaches is necessary to ensure that the resulting standards are high quality and reflect the economics of the business.

If you have any questions regarding the contents of this letter, please contact Michael Monahan at 202-624-2324. Thank you in advance for your consideration in this matter.

Sincerely,



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