



April 20, 2010

Sent by Email

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

Mr. Robert H. Herz
Chair, Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116 United States

Dear Sir David and Mr. Herz:

Re: Insurance Contracts Project – Discount Rate

Although the life insurance members of GNAIE are pleased to see that the topic of discount rates for insurance contracts will be discussed at the joint IASB/FASB meeting agenda on April 21, 2010, we have key concerns that we believe should be included in the assessment and analysis phase of the discount rate topic.

The importance of the discount rate topic is not the same for all product types. For the companies and jurisdictions that sell long duration guaranteed products, the discount rate topic is among the most important of all the insurance contract project topics. This is because the investment risk for these products is a significant portion of the overall product risk, and is often greater than the policyholder related risks.

Because of the importance of the topic, Manulife and MetLife, the two largest North American insurance companies (as measured by market capitalization), participated in the IASB field-testing of insurance contracts.

The GNAIE concerns can be summarized in four areas:

- 1. Earnings emergence patterns on long duration guaranteed products.**
- 2. Potential consequences for the capital markets and consumers.**
- 3. The “relevance principle” of the resulting financial reporting results, and potential use of non-GAAP measures.**
- 4. Current accounting policies used for long duration guaranteed products.**

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

Each of these items is expanded upon below:

1. Earnings emergence patterns on long duration guaranteed products

- The discount rate accounting policy is a material¹ component of the valuation of policy liabilities for long duration guaranteed insurance products.
- Insurance companies in North America, Korea, Taiwan, Chile and companies in several countries in Asia and Latin America as well as companies in the United Kingdom that provide annuity products have material books of long duration guaranteed products.
- A discount rate based on either a single reference rate or a risk free rate plus liquidity premium, will lead to significant income volatility as a result of temporary fluctuations in the interest rates markets and the approaches proposed in the staff paper are “fundamentally flawed”.
- The combination of the following factors is what results in the flaw:
 1. the rate used to discount the liabilities does not represent a portfolio that an insurance company would hold to support its policy liabilities,
 2. in order to dampen the accounting mismatch that would arise if liabilities were fair valued and assets were not, the fair value accounting option will be used to value assets supporting policy liabilities, and
 3. the duration of both the assets and the liabilities is long.
- An appropriate assessment and analysis of the field-testing results must be based on separating the results of long duration guaranteed products from other products.

2. Potential consequences for the capital markets and consumers

- Since Insurance companies are one of the largest segments within the financial sector, there should be an assessment and analysis of the potential consequences of the accounting policy on capital markets.
- Model-driven volatility could affect the cost of capital as a result of the additional risk premium that investors likely would require and lead to an increase in product prices to compensate for the additional cost of capital.
- To reduce their increased cost of capital, companies might reconsider their product mix, asset mix and investment horizon decisions.
- The resulting investment portfolios could have high concentrations in “reference” assets with shorter investment horizons.
- This in turn would have a negative impact on the demand for long-term debt with a corresponding negative impact on capital formation.

3. The “relevance principle” of the resulting financial reporting and the potential use of non-GAAP measures

- There should be an assessment of the discount rate policy with respect to the financial reporting principle of “relevance”.
- While a discount rate that is based on a single reference rate may achieve a certain amount of comparability in the valuation of policy liabilities, it also misrepresents the risk profile of the business and does not represent the market risk premium that marketplace participants would expect for bearing the uncertainties in cash flows.
- The financial reporting results for providers of long duration guaranteed insurance contracts will be model driven and, therefore, will not provide relevant financial information.
- This would result in preparers expanding their use of non-GAAP information in order to provide relevant information to users.

4. Current accounting policies used for long duration guaranteed products

- Other options to address the discount rate issues should be more thoroughly assessed.
- The insurance industry in North America has discussed a few potential approaches to the discount rate policy. These approaches incorporate what we believe works in existing Canadian and US GAAP.
- The approaches range from an amortized cost approach to looking to the types of assets used to support the payment of the policy obligations.
- We believe that there is an argument for determining the investment risk characteristics (as opposed to underwriting risk or policyholder behavior) of the insurance contract liability (which are not directly observable), by considering the future return on the assets that are managed to support the expected cash flows of the insurance contract obligations (a subtle but important difference). This rate would include appropriate adjustments for the credit risk relating to the assets and the risks relating to underwriting and policyholder behavior would be addressed by other assumptions used in the valuation models.
- Although the IASB/FASB staff paper states that “the characteristics of the liability are not best reflected in a discount based on expected returns on assets backing those liabilities”, a model similar to that has been used successfully across the worldwide operations of Canadian life insurance companies.
- Because the Canadian GAAP methodology is aligned with the business model, Canadian companies do not need to use non-GAAP measures to explain their results. In other words, the financial results meet the “relevant information” test.

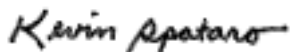
We are not suggesting that the new standard be equal to the existing Canadian standard, but instead that the concepts that are the strength of the Canadian model be considered.

We believe that a discount rate policy based on recommendations in the staff paper will increase the use of non GAAP measures and have unintended consequences on capital markets and consumers.

There is no easy answer to the discount rate issues. However, because of the significance of this issue we urge the Boards to ensure that the standard setting process includes a carefully identified, framed, analyzed and debated assessment of the key issues.

We would welcome the opportunity to discuss the issues and potential solutions with you.

Best regards,

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

Chair, GNAIE Accounting Convergence Committee

cc: Warren McGregor, Chair, IASB Insurance Working Group
Paul Cherry, Chair, IFRS Advisory Council

KAS:LS:c11

ⁱ The pre-tax income sensitivity to a change in the discount rates under the policies recommended in the IASB/FASB staff paper can be calculated as: Liability Value multiplied by Duration multiplied by the Change in Rates. Therefore based on the recommendations in the IASB/FASB staff paper, the pre-tax income sensitivity to a 100 BPS change in interest rates between the assets and liabilities, on a \$100 billion block of business with a 1-year duration, is \$1 billion, and for a block of business with a 12 year duration is \$12 billion.