



February 20, 2009

Mr. Jeffrey Cropsey
Project Manager, Insurance Contracts
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Dear Jeffrey:

As you prepare for next Wednesday's Board meeting, we wanted to take the opportunity to provide additional insight into GNAIE's Alternative Measurement Approach ("AMA") for non-life insurance ("NLI") contracts. Our hope is that if this AMA is not currently on the Board's agenda, that you might consider it as an addition.

Our request takes on even greater importance in light of the IASB's recent discussion of AMA's where we observed confusion around the role of risk margins. Moreover, while encouraged that Sir David Tweedie brought up the issue of GNAIE's AMA for NLI contracts at the IASB's most recent meeting, we were at the same time discouraged it was not brought up until the meeting was in the process of adjournment; as a result no reasonable discussion ensued. Considering the size and importance of the global NLI market, the fact that the same basic measurement model (which is well understood from both a preparer and user perspective), is used around the world for NLI contracts but it does not resemble any of the current four measurement candidates under consideration, indicates an in-depth discussion of NLI AMA's, similar to that which we believe has principally focused on AMA's for life insurance contracts, is absolutely necessary.

As previously discussed, the three primary issues are (a) the use of an unearned premium reserve during the pre-claim period, (b) the introduction of risk margins and discounting to a measurement model for NLI contracts, and (c) the identification of an appropriate measurement model for NLI contracts during the post-claim period.

GNAIE believes the appropriate AMA for NLI contracts is one that includes the following elements:

- ❖ Use of an unearned premium reserve ("UPR") during the pre-claims period. We believe NLI contracts are essentially service contracts where the service provided is insurance protection. The NLI contract is executory in nature and as such no insurance protection services will have been provided at inception and consequently there is no gain recognizable at inception. UPR would be evaluated for adequacy at each reporting period.

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- ❖ Use of implicit as opposed to explicit risk and profit margins. Introducing explicit risk margins and explicit profit margins to a measurement model for NLI contracts would be inappropriate as there exists no independent, reliable, or otherwise verifiable source, to which those margins could be continuously calibrated. Alternatively, we believe continuing to follow the service contract model, similar to that which is presented in the Board's Revenue Recognition Project, is the most appropriate alternative. That guidance would periodically recognize (or "earn") UPR proportionate to the provision of risk protection services over the protection (i.e., coverage) period.

As UPR is earned, incurred claims (both reported and not reported) and expenses are recognized; the net of which is commonly described as ***underwriting income (or loss)*** – the key performance metric for non-life insurers. Net investment income and income taxes are added to underwriting income to produce net income. The periodic development of underwriting income (or loss) is the mechanism through which implicit margins emerge in an insurer's financial statements when applying GNAIE's proposed AMA for NLI contracts (similar to existing US GAAP).

We believe the introduction of explicit risk and explicit profit margins, while certainly mechanically possible, would impair the understandability of both non-life insurer's financial statements and their periodic performance. More specifically, calculating and applying explicit risk and explicit profit margin assumptions by month or quarter would be both exceedingly complex and difficult to cost justify for typical NLI contracts with coverage periods of twelve months or less. It would also inappropriately suggest to investors that a level of precision in predicting uncertain future events has been attained (presumably through the use of financial modeling) which is clearly not the case. To support this assertion, we need look no further than the current worldwide credit crisis where the world's most sophisticated models and modelers failed on such a colossal scale to foresee uncertain inter-dependent events.

GNAIE's AMA for non-life insurance is best described as an "incurred model" as opposed to an "anticipated model". We firmly believe an incurred model best serves the dual needs of financial statement preparers, to provide stakeholders with objective, understandable, fully transparent information, and of stakeholder's to receive information that is reliable, verifiable, understandable, decision useful, and fully transparent. We believe markets function most efficiently and effectively when market participants understand both the composition and mechanics of both the financial statements and business models of the companies in which they invest. Alternatively, we have witnessed the risks and outcomes of markets that rely on sophisticated models, a limited number of sophisticated modelers, and a general lack of transparency and understandability on the part of investors.

- ❖ Use of undiscounted best estimates of incurred claims. GNAIE considers the issue of discounting similar to risk margins inasmuch as we do not believe introducing discounting to an AMA for NLI contracts would be appropriate as the inherent volatility in NLI claims results in a high degree of imprecision in the estimated reserve and the associated pay-out pattern. Accordingly, it is GNAIE's long-standing position that stakeholder's needs are best served by providing them with claim estimates that have not been discounted or grossed up through the application of explicit risk and explicit profit margins. The significance of the imprecision inherent in those estimates, as well as the complexity of the models needed to derive the estimates and the interdependencies between the model assumptions, all come together to make the resulting financial statements incomprehensible by all but a small handful of highly sophisticated insurance actuaries and accountants. Such obfuscation of results clearly would not lead to decision useful information and therefore we do not believe this would be a desirable outcome.
- ❖ The last item, which is often overlooked, relates to the measurement model to be applied to NLI contracts in the post-claim period. For the reasons stated above, GNAIE believes the post-claim measurement model should be an undiscounted model that utilizes best estimates of the ultimate settlement amount of incurred claims. Again, our goal is to provide information to stakeholders that achieve the highest levels of reliability, verifiability, understandability, decision usefulness, and transparency.

As you know the need for separate models for life and NLI contracts has been a basic position of GNAIE since its inception. Moreover, as the Board's continue to evaluate AMA's we think now is the right time to have a full discussion of the merits of GNAIE's proposed model for NLI contracts. As stated previously, we fully understand that the FASB and IASB may ultimately not agree with our position, however, we nonetheless believe it is critical that the evaluation take place and that a public dialogue is held to ensure the underlying issues, some of which are articulated above, are fully considered.

If you think that it would be helpful to discuss this by phone before the meeting next Wednesday, please let me know and we can arrange for a call.

Thank you for considering our views on this matter,

Sincerely,

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

Kevin Spataro
Chairman, GNAIE Accounting Convergence Committee

cc: Mark Trench

Hans van der Veen