

May 19, 2006

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

### **The May IASB Meeting**

Dear Sir David

At the May meeting of the IASB we understand that there will be discussion of several topics related to Phase II of the Insurance Contracts Project. The Group of North American Insurance Enterprises (GNAIE) and the four Japanese Life Insurers offer the comments below on these issues.

As was true in previous meetings this year, most of the issues on the May agenda (in *Italics* below) were discussed at the Insurance Working Group (IWG) and are covered in the principles that we and the CFO Forum have already published. Some, however, may not have been thoroughly explored as of yet and our position on others may not have been fully stated at the IWG meetings. These comments are not intended to be a final and complete discussion of the issues, but are a summary based on our continuing discussions with users, preparers and other interested groups. Furthermore, they reflect insights gained by our efforts at modeling alternatives; a process that we believe should be critical to the Board's decision-making process.

**Universal life contracts.** *Universal life contracts give more discretion than traditional life insurance contracts to both policyholders and the insurer. How does such discretion affect recognition and measurement?*

Universal life contracts should be treated like all other life insurance contracts. The measurement of insurance contract liabilities should be equal to the present value of all future expected benefits and expenses, without exception, less the present value of future gross premiums. Future expected benefits would include expected non-guaranteed benefits that would arise from the market or entity-specific assumptions being used. The second paper from the IAA/ACLI task force dealt with this issue in some depth.

**Unit-linked and index-linked payments.** *How should an insurer:*

- *Measure obligations denominated in units of an internal or external investment fund?*
- *Measure and present the assets of an internal fund linked to such obligations?*

- *Account for revenue (e.g. investment management fees) and expense (including acquisition costs) related to such contracts?*
- *Measure guarantees of unit prices?*

Likewise, unit-linked contracts should be treated like all other life insurance contracts (assuming the contracts qualify as insurance contracts, not investment contracts). The insurance contract liability should be equal to the present value of future expected benefits and expenses, without exception, less the present value of future gross premiums as previously noted. The discount rate should always be based on the expected return on the investments underlying the liability. In this way, the liability should be equal to the fund balance, except in early years when a surrender charge may cause the liability to be slightly less than the fund value.

Investment fees charged against the fund are not the same as the fees charged against, for instance, mutual funds. While unit-linked investment fees may appear to be investment fees, in reality they may cover other risks such as mortality. The pricing of the product is done holistically and an attempt to disaggregate the investment fees from the mortality charges will not faithfully represent the contract.

Guarantees of unit prices should be valued as part of the liability.

**Credit characteristics of insurance liabilities.** *Should the measurement of insurance liabilities include the effect of their credit characteristics?*

The credit characteristics of insurance liabilities or of an entity should not be considered in the valuation of insurance liabilities.

A system that results in a liability decreasing when a hypothetical insurance liability rating or a company's rating is decreased leads to a result that is misleading and confusing. Even if one assumes that liabilities only decrease near insolvency, the result is still inappropriate. Insurance regulation and other mechanisms in most jurisdictions guarantee payments to policyholders. Thus, a policyholder, in general, would not accept less than the contractual or face amount owed.

**Reinsurance.** *How should a cedant measure its rights under a reinsurance contract? Does the answer have implications for policyholder accounting? (We do not plan to address policyholder accounting in the Discussion Paper, but plan to cover it in the Exposure Draft.) Do reinsurance contracts have any characteristics that might justify treatments that differ from those proposed for direct insurance contracts?*

GNAIE considers as follows: When a reinsurance contract is structured such that the ceding company is relieved of its legal liability to the policyholder, it is considered a legal replacement of the original insurer ('novation'). In this case, the ceding enterprise should remove the assets and liabilities related to the contract from its financial statements and gains or losses should be immediately recognized. If the ceding enterprise

is not relieved of its legal liability, then the assets and liabilities should remain on the ceding company's financial statements. The measurement of any assets or liabilities resulting from the reinsurance contract that meets risk transfer criteria should follow the same accounting guidance for insurance contracts for both the ceding and assuming company.

An assessment of features that limit the reinsurer's insurance risk or postpone claims reimbursement by the reinsurer should be examined to determine whether a contract provides this indemnification from liability. For short-duration contracts, transfer risks should be examined to determine if there is a probability of a significant loss; for long-duration contracts, mortality or morbidity risks should be evaluated. Deposit accounting should be used to record reinsurance contracts that do not provide the Company with indemnification against liability or loss by the reinsurer.

The accounting for the reinsurance contract should be separate from the accounting of the insurance contract with the policyholder and should not impact policyholder accounting.

**Salvage and subrogation.** *How should salvage and subrogation rights be treated?*

GNAIE believes that non-life claims liabilities should include expected salvage and subrogation recoveries. Essentially, estimated recoveries on unpaid claims, such as salvage and subrogation, should be evaluated in terms of the estimated realizable value and should be deducted from the unpaid claims liabilities.

**Business combinations and portfolio transfers.** *To consider whether the Discussion Paper needs to address insurance contracts acquired in business combinations and portfolio transfers.*

Insurance contracts acquired in business combinations and portfolio transfers should be treated like all other insurance contracts. For business combinations, we urge the IASB to specifically address the valuation/measurement of insurance contracts in connection with the allocation of purchase price in the absence of specifically negotiated values for underlying portfolios of insurance contracts.

**Changes in insurance liabilities.** *When (if ever) should an insurer recognize premium receipts as revenue? When (if ever) should an insurer recognize them as deposit receipts?*

We support the tentative conclusion of the Board, as described in the April 2006 IASB Update, that "it should not require insurers to unbundle deposit and service components of insurance contracts for the purpose of recognition and measurement." If a contract meets the definition of an insurance contract, all of the premium receipts should be recognized as revenue.

In addition, the issues of presentation should be dealt with after due consideration of recognition and measurement for insurance contracts.

**Overview of relevant FASB projects.** *To review developments in FASB projects on risk transfer, life settlements and financial guarantees, and assess implications for the discussion paper.*

We strongly encourage the FASB and IASB to work together on each of these projects, as well as the FASB's Fair Value Measurement project, and issue consistent guidance. Once published, guidance should be final and not subject to change, especially by another active project, which would likely lead to significant implementation costs and confusion to users of insurance company financial statements.

**Participating features.** *To consider follow up issues from the discussion in March.*

As we described in our letters for the March and April IASB meetings, as well as our extended life insurance principles, liabilities for participating contracts must include provisions for the expected payout of policyholder dividends. We encourage the IASB to continue discussions on this topic at the June IWG meeting.

The idea of including provisions for future dividends in equity, even if they are distinguished from equity attributable to shareholders, will lead to huge gains being recognized at inception, which is irrational and misleading. In addition, such treatment is inconsistent with the tentative decision on the measurement attribute at the April Board meeting. While we do not support that decision, the exit value will include the amount to be distributed to policyholders as future dividends because, in the case where participating contracts are to be transferred to another insurer, the transferee will request that the amount be included in the calculation of a transfer price.

We disagree that the notion of a legal or equivalent compulsion is the most appropriate test to determine whether an insurer should recognize a liability relating to expected dividends to participating policyholders. Although the distribution to policyholders may not occur until some time in the future, the obligation to do so already exists. We suggest a determination based on such a criterion.

**Long-term savings contracts.** *To consider whether any conclusions reached for insurance contracts have implications for the treatment of long-term savings contracts.*

As discussed above in "Changes in insurance liabilities", if a contract meets the definition of an insurance contract, premiums should be recognized as revenue. Financial products which have the same economic characteristics should be accounted for consistently, and accounting rules should deal with differences in characteristics between similar products after due consideration.

We hope that these brief comments will be of help to the Board in its upcoming discussions. Again, we appreciate that the Board and Staff have created the open process we have seen at the Insurance Working Group and look forward to participating in future meetings. If you or any Board Member would like clarification of our position on these issues, we would be glad to provide it.

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### **Group of North American Insurance Enterprises**

Richard J. Carbone, Chair, CFO  
Prudential Financial, Inc.

William G. Gasdaska, CFO  
General Reinsurance Corporation

Jerry M. de St. Paer, Vice Chair, CFO  
XL Capital, Ltd.

Richard P. McKenney, CFO  
Genworth Financial, Inc.

Philip Bancroft, CFO  
ACE Ltd.

Robert Price, Controller  
The Hartford

Steven J. Bensinger, CFO  
AIG, Inc.

Joseph J. Prochaska, Jr., CAO  
Metropolitan Life Insurance Company

Danny L. Hale, CFO  
The Allstate Corporation

Michael E. Sproule, CFO  
New York Life Insurance Company

Marc Meiches, CFO  
GE Insurance Solutions

### **Japanese Life Insurance Companies**

Takao Arai, Executive Vice President,  
Nippon Life Insurance Company

Kazuma Ishii, Managing Executive Officer,  
Dai-ichi Life Insurance Company

Hiroaki Tonooka, Managing Director,  
Meiji Yasuda Life Insurance Company

Koji Hanaoka, Managing Director,  
Sumitomo Life Insurance Company