



April 27, 2010

Mr. Robert Herz, Chairman  
Financial Accounting Standards Board

*Sent via email*

Sir David Tweedie, Chairman  
International Accounting Standards Board

Dear Sir David and Mr. Herz:

We listened with great interest to the joint Board discussion on April 21 of the two approaches that the Boards have been considering for margins in measuring insurance contract liabilities. We note in the cover note paper for that discussion (IASB agenda reference 3, FASB memo reference 43) that the Boards have tentatively scheduled a follow-up meeting for May 4 to make a choice between the two approaches. In this letter, we provide additional comments for consideration in your May 4 meeting with respect to life insurance contract liabilities. As you know, we oppose use of explicit margins in measuring non-life insurance contract liabilities; and we are sending a separate letter to you to highlight the reasons for our position.

We understand the theoretic rationale that is the basis for the two margin approach (risk adjustment plus residual margin) that some IASB members advocate. However, it is abundantly clear from discussions in the March and April joint Board meetings and from the two papers that IASB/FASB staff wrote recently on this subject (IASB agenda reference 6D, FASB memo reference 41D in March; and IASB agenda reference 3A, FASB memo reference 43A in April) that there are wide ranges of methods and assumptions that insurance companies could use to calculate numbers that could be called risk margins. The results of such calculations would not be comparable among companies; and many users and preparers of financial statements (including our members) are highly skeptical that such results could be decision-useful.

A possible solution would be for the Boards to prescribe a method for calculating the risk margin, with sufficient specificity to curtail divergence in practice. However, such prescription would be contrary to the Boards' goals for principles-based standards, and would likely impose requirements that are not appropriate for many types of insurance. For similar reasons, the Boards discussed and apparently rejected a suggestion at their joint meeting on April 21 that insurers could provide disclosure of risk margins relative to a prescribed baseline method of calculation.

Jerry M. de St. Paer  
Executive Chair

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The alternative approach for margins that the Boards are considering (a composite margin) is objectively calibrated at inception, without requiring a split that is dependent on speculative calculation of an amount to be represented as a risk margin. From recent discussions in joint Board meetings, it appears that some IASB members object to the composite margin because they believe that it suffers from one or more of the following weaknesses:

- 1) No margin is required in the onerous contract test that would be applied in the composite margin approach (i.e., an insurance contract is not considered to be onerous if the present value of net future cash outflows for the contract is equal to or only slightly less than the reserve liability for the contract with no margin).
- 2) The composite margin is not easily subject to remeasurement.
- 3) The composite margin does not provide information about the relative riskiness of a company's liabilities.

We believe that even after these factors are considered, the composite margin approach is still the most useful approach for margins in measuring life insurance contract liabilities. The composite margin is intended to cover all sorts of adjustments to the present value of net cash flows, including a risk margin. All margins, whether labeled as a risk margin, a residual margin, or a composite margin, are amounts that are available to pay claims. Such amounts would become earnings over time if they are not needed for that purpose. Once a loss is recognized for an onerous contract, it is not necessary to impose a theoretical margin in addition, as such a margin would merely create an additional loss today with an expectation of an offsetting profit in the future.

In the normal course of business, the composite margin calibrated at inception would be run off in an orderly manner as the insurer is released from risk. It is possible that new information could emerge over the life of a portfolio of insurance contracts that would cause the insurer to make changes in the composite margin. The staff paper on composite margin for the April joint Board meeting (IASB agenda reference 3B, FASB memo reference 43B) indicates that reallocation of the composite margin based on significant changes in the timing or amounts of the contractual cash flows could provide useful information. It was also suggested in the joint Board discussion on April 21 that the insurer could re-determine the composite margin of inforce insurance contracts if it significantly changed its pricing assumptions or methods. Such changes are possible, but we believe that they would be relatively rare. Redetermination of expected cash flows would be far more common. If the margin is related to those expected cash flows, the margins would be recalculated based on changes in the expected cash flows.

We continue to believe that efforts to define an explicit risk margin for insurance contracts are based on theoretical development that is not decision-useful to investors or to insurance entities. We do recognize, however, that information about the riskiness of a company's liabilities is important to users of financial statements. Such information cannot be provided in a meaningful way by displaying one number (i.e., a calculated risk margin). Instead, a thoughtful discussion of the risks involved (including possible ranges of outcomes) would be far more helpful and could be included in management's discussion and analysis. In our view, such disclosures and discussions would be far more useful than a theoretical division of the margin would be.



We ask that you consider these comments as you prepare for your next discussion of risk adjustment for insurance contracts, and as you proceed to finalize an exposure draft that will hopefully lead to an effective converged international accounting standard for insurance contracts.

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: Mel Anderson, Chair, NAIC International Accounting Standards Working Group  
Rob Esson, Chair, IAIS Insurance Contracts Subcommittee  
Peter Windsor, Secretariat, IAIS Insurance Contracts Subcommittee

KAS:KK:cll