



May 27, 2010

Mr. Joseph Fritsch
Director of Insurance Accounting Policy
State of New York Insurance Department
25 Beaver Street
New York, NY 10004

Dear Mr. Fritsch:

As you know, the work plans of both the FASB and the IASB provide for issuing an Exposure Draft for a new accounting standard for insurance contracts in early July, and for finalizing a standard by the middle of next year. GNAIE has been following these developments closely as the project has progressed over these last several years. As the release of the Exposure Draft draws near, we remain gravely concerned about the overall direction of the project with regard to accounting for non-life insurance contracts as well as specific, critical decisions regarding the accounting for life insurance contracts. In particular, we believe that the IASB's decision to apply essentially the same model to both life and non-life insurance contracts, which introduces probability weighted cash flows, discounting and explicit risk margins to non-life insurance contracts, and the FASB's decisions on expensing transaction (i.e., acquisition) costs and determining discount rates, will not produce a workable general-purpose (or regulatory) accounting standard.

Both the IASB and the FASB have devoted considerable time and effort in development of a converged standard; but considerable differences remain between the tentative positions of the Boards, and the FASB has not yet deliberated some of the key issues on which the IASB has taken tentative positions (e.g., separate models for life and non-life insurance contracts, and discounting and explicit risk margins for non-life contracts). While both Boards remain committed to completing this project, it is not clear how, when, or even if the differences in positions will be resolved.

The International Accounting Standards Working Group (IASWG) is developing tentative positions regarding "an expected IFRS model" for general-purpose accounting. As part of its charges, the IASWG should seek the input of and coordinate with the SAPWG with regard to issues that potentially affect U.S. GAAP. We urge the Statutory Accounting Principles Working Group (SAPWG) to engage with the IASWG at its earliest convenience in order to provide technical assistance to that group as it forms its policies and advocates on these important issues.

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Given the potential near-term impact of U.S. GAAP standards on insurer regulatory statements, it makes sense for the SAPWG to consider these proposals and provide input on the direction of these projects to the IASWG and FASB, in order to achieve a result that is usable as a basis for regulatory reporting with potential adjustments. The result of these proposals will also affect the health of the insurance industry both in terms of marginal cost and cost of capital. As users of general-purpose financial statements (for comparison to statutory) and experts in insurance reporting and valuation, U.S regulators are uniquely positioned to provide relevant, credible expert opinion as to the best practices in insurance accounting.

We list below the issues that we think may be most challenging for statutory accounting, stressing the issues on which the FASB and IASB have not yet been able to reach a consensus position.

- 1) Issues on which the IASB has reached tentative positions, but which the FASB has not deliberated (but indicates that it plans to discuss at a future meeting).
 - a) Two models? – (Other than as noted below for unearned premiums) The IASB position is that all insurance liabilities (including non-life insurance claim liabilities) should include discounting and explicit margins (the building block approach), while the FASB indicates that it will consider at a future meeting whether in certain instances (e.g., short-duration non-life contracts) a measurement of insurance contracts would use future cash flows with no margins and no discounting.
 - b) Unearned premium – The IASB position is to require (rather than permit) use of an unearned premium approach for pre-claim liabilities of short-duration insurance contracts, while the FASB indicates that it will discuss an unearned premium approach at a future meeting. It is unclear how a portion of an implicit composite margin included in the unearned premium reserve would be run-off over the claim paying period under such a scenario.
- 2) Issues on which the FASB and IASB have reached different tentative positions.
 - a) Margin(s) - The IASB position is to include a risk adjustment plus a residual margin in insurance liabilities, while the FASB position is to include a composite margin. (At a recent joint Board meeting, we believe they decided to include both positions in the Exposure Draft). The composite margin and the risk adjustment would be run-off over the entire claim paying period thus impacting revenue and profit emergence and recognition.
 - b) Acquisition costs - The IASB position is to match the treatment of premiums and incremental acquisition costs (IASB staff is investigating whether both should be included or excluded in determining the initial liability), while the FASB position is to expense all acquisition costs when they are incurred without recognizing any revenue (or income) to offset those costs.
 - c) Participating features – The IASB position is that payments arising from such features should be included in measurement on an expected present value basis, while the FASB position is that they should be included only to the extent that the insurer has a legal or constructive obligation to make those payments.
- 3) In addition, the following are key issues on which the IASB and FASB appear to have reached tentative consensus conclusions that may be challenging to consider in relation to statutory accounting.
 - a) Discount rate – The Boards decided tentatively that the discount rate should reflect characteristics of the liability, rather than characteristics of assets actually held to back that

liability, unless the cash flows for the liability depend wholly or partly on the performance of specific assets.

- b) Probability-weighted cash flows – The Boards decided tentatively that the measurement approach should use the unbiased probability-weighted average of future cash flows expected to arise as the insurer fulfills its obligations.
- c) Statement Presentation – Though it is somewhat unclear what their position is, the Boards appear to have tentatively decided to require a net “margins” presentation that does not distinguish between underwriting components.

It may be constructive and appropriate for the SAPWG to discuss some or all of the issues listed above with the FASB, if possible before the FASB issues an Exposure Draft, to make sure that the FASB is aware of questions and concerns that the positions on these issues may present for US statutory accounting, especially with respect to non-life insurance contracts. While one answer may be that accounting that is appropriate for general purpose financial reporting may not be appropriate for regulatory reporting and supervision, the systems are currently related through the NAIC’s statutory accounting hierarchy, and it is legitimate for regulators to raise questions if they believe that proposals for general purpose reporting do not reliably reflect the nature of the reported liabilities.

We would be happy to discuss our specific concerns, and any other concerns and questions you may have on these subjects.

Sincerely,

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

Kevin Spataro
Chair, GNAIE Accounting Convergence Committee

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