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Financial Accounting Standards Board
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Exposure Draft–*Insurance Contracts*
File Reference No. 2013-290

The Financial Reporting Executive Committee (FinREC) and the Insurance Expert Panel, both of the American Institute of Certified Public Accountants (AICPA), appreciate the opportunity to comment on the Financial Accounting Standards Board (FASB) Exposure Draft–*Insurance Contracts* ("FASB ED"). Additional input was also received by members of the AICPA Depository Institutions Expert Panel, Employee Benefit Plans Expert Panel and Health Care Expert Panel.

FinREC continues to support the efforts of both the FASB and the International Accounting Standards Board (IASB) to either converge or more closely align U.S. generally accepted accounting principles (U.S. GAAP) with the International Financial Reporting Standards (IFRS). However, as we have stated in previous letters, high quality accounting standards should not be sacrificed for the sake of convergence. We also note that U.S. generally accepted accounting principles (GAAP) comprehensively addresses accounting for insurance contracts by insurance entities, whereas IFRSs do not have comprehensive insurance guidance. We understand that FASB has not yet evaluated if the benefits that are expected from the proposed changes exceed the cost, nor whether targeted improvements should instead be made to U.S. GAAP. Our letter has not addressed areas where targeted improvements, if the FASB decides to follow that approach, should be considered.

We believe that if the FASB decides that changes are necessary to U.S. GAAP beyond targeted improvements then the following are key areas that the FASB and the IASB should seek convergence on:

- Unlocking the Margin - changes in estimates of future cash flows, which are related to future coverages or services, should be recognized as adjustments to the margin (see our response to Question 13)
- Fulfillment Cash Flows –should include a measurement for the uncertainty related to the allocation of probable outcomes (see our response to Question 12)
- Definition of Portfolio - the definition of a portfolio of insurance contracts should take into account how entities manage their business (see our response to Question 8)
- Acquisition Costs - what qualifies as acquisition costs and the accounting for acquisition costs paid (see our responses to Questions 28 and 29)

- Transition – practical expedients should allow for the use of hindsight (see our response to Question 44)

Our comments in this letter have been prepared to provide feedback on the FASB ED. We do not fully support the building block approach ("BBA") or the premium allocation approach ("PAA") as currently proposed or the proposed presentation of the models. Included in our response to the specific questions we have provided suggestions on certain aspects of the proposed approaches. We would suggest that the FASB consider the following observations:

Scope: We agree that the guidance should apply to contracts that meet the definition of an insurance contract, and should not be based on the legal type of entity that may have issued the contract. However, we are concerned that without modifications to the definition of an insurance contract the population of arrangements that would be required to use the guidance would be too broad.

One area of concern is that the proposed scope includes arrangements that are predominantly based on credit risk as insurance contracts. We believe that the FASB should rethink how arrangements that are predominantly based on credit risk be classified. We believe that contracts whose primary purpose is to provide the issuing entity with exposures to credit risk, that are not currently accounted for as insurance contracts, should be included in the financial instruments project. We also recommend that the FASB consider if changing accounting models for arrangements that are predominantly based on credit risk and are not currently accounted for as insurance contracts, would be appropriate from a cost benefit perspective.

Another area of concern is that the FASB ED indicates insurance must cover a pre-existing risk, and this concept is not well understood outside the insurance industry. We believe further clarification is needed to explain if a risk should or should not be considered a pre-existing risk and separated from an overall arrangement between two parties for the purposes of assessing whether it is to be considered within the scope of the FASB ED.

We are also concerned with the lack of clarity in determining whether fixed-fee service contracts have the primary purpose of providing a service. While we agree with the scope exclusion for fixed-fee service contracts provided in 834-10-15-5 of the FASB ED, we request clarification in determining at what point a contract has the primary purpose of providing a service.

Therefore, we recommend that the FASB reevaluate whether the definition of an insurance contract should be modified to avoid expanding the application of the guidance to contracts that should not be accounted for under the insurance contract guidance.

Premium Allocation Approach: We recommend that for contracts that would be required to apply the premium allocation approach ("PAA"), but that are managed with contracts accounted for under the BBA, entities should be permitted to apply the BBA to all the related contracts. Some insurance entities may wish to apply the BBA to all insurance contracts managed together for ease of administration and consistency in presentation. Entities would also be required to disclose this election.

Portfolios: Currently there is diversity in U.S. GAAP with respect to how entities aggregate contracts for measurement resulting in difficulty for users in comparing financial statements. While we agree that the definition of a portfolio of insurance contracts should be addressed in the final guidance, we do not agree with the definition included in the FASB ED.

We strongly recommend that the FASB and the IASB converge on this issue, as differences in the definition of a portfolio of insurance contracts will result in significant reporting complications for multinational entities. The definition of a portfolio of insurance contracts as defined in the IASB exposure draft ("IASB ED"), that takes into account how entities manage their business, is more appropriate. The proposed definition of an overall portfolio of insurance contracts in the FASB ED may require a more granular level of portfolios than how entities manage their business and may not be justifiable from a cost benefit perspective.

We also believe that for certain measurement amounts it may be necessary to group insurance contracts into a smaller unit of account than the portfolio. For example, when determining the discount rate and margin, and unlocking the margin. We recommend that the final guidance acknowledge that different groupings would be permitted.

Discount Rates: We agree that an entity should separately present the effects of underwriting performance from the effects of changes in discount rates, but do not agree that changes in the present value of the fulfillment cash flows due to changes in the discount rates should be required to be included in other comprehensive income due to the potential accounting mismatches and resulting volatility in earnings.

We believe that an entity should be allowed to make an accounting policy decision in an attempt to mitigate volatility in earnings (similar to the fair value option) in regards to whether changes in discount rates should be recognized in other comprehensive income or net income. We believe that this election should be consistent with any final decisions on the fair value option election under the FASB's financial instruments project.

Fulfillment Cash Flows: We are concerned that using fulfillment cash flows (the present value of the explicit, unbiased and probability-weighted estimates of the future cash flows) as defined in the FASB ED would not include a measurement of the uncertainty related to the allocation of probable outcomes, and may not accurately reflect the measurement of the insurance liability.

We believe that both the BBA and PAA should include the principle that there is uncertainty in cash flows related to the allocation of probable outcomes. There is diversity among the various individuals within the AICPA group that compiled this letter regarding how the uncertainty should be included in the measurement models. There are various ways that uncertainty could be captured in both approaches such as; including an explicit or implicit risk adjustment or amortization of the margin or premium over the coverage and settlement period.

We also request further clarification as to the unbiased measurement of cash flows and the interaction with probability-weighted estimates. It could be inferred that the use of

probability-weighted estimates implicitly includes the use of management bias, to determine the weightings. We recommend that the final guidance further elaborate on what judgments are allowable and still considered unbiased.

Specifically we believe uncertainty is not fully included in the PAA, as the premium is amortized only over the coverage period and the liability for incurred claims is discounted.

We recommend that the FASB reconsider how to include the uncertainty in the cash flows.

Unlocking of the Margin: We believe that changes in estimates of future cash flows, which are related to future coverages or services, should be recognized as adjustments to the margin instead of in net income. The original amount included in the margin is an estimate of future expectations, and we do not believe it is appropriate to recognize current period refinements of the estimate for those future cash flows in net income.

We believe recognizing estimates of future cash flows and changes to future expectations of those estimates both in the margin will result in more relevant measure of unearned profit in the financial statements.

Acquisition Costs: We request that the FASB and the IASB strive for convergence on what qualifies as acquisition costs, as we believe it will be confusing to users of financial statements. We believe that costs for unsuccessful efforts should not be included as acquisition costs.

We also request that the Boards strive for convergence on accounting for qualifying acquisition costs as a component of the margin or included as part of fulfillment cash flows. We believe that this is a fundamental difference that will make comparability among U.S. and international insurance entities unnecessarily difficult.

Business Combinations: We do not agree that entities should record a loss at the acquisition date in the amount by which any excess of the asset and liability balances related to insurance contracts measured in accordance with the guidance in the FASB ED exceeds the fair value of those assets and liabilities.

We believe that the proposal in the FASB ED to recognize a loss at the acquisition date would be an overall exception to the principles in ASC 805, *Business Combinations*, that has not been thoroughly explained. If the FASB proceeds with the guidance proposed, we request further elaboration why such an exception would be appropriate for the acquisition of insurance contracts under a business combination.

Presentation: Although we believe it is better to present insurance contract revenue and incurred expenses in the statement of comprehensive income rather than only changes in the margin, we are concerned that the current proposed presentation approach may not provide users with a relevant financial measure.

We agree with the objective of providing volume information in the statement of comprehensive income for contracts under both the BBA and the PAA that aligns the underlying concepts with the principles outlined in the anticipated revenue recognition standard. However for insurance contracts under the BBA the period of time from inception until settlement can be for many years, and often decades, so following the principles under the proposed revenue recognition standard may not meet user needs and would require extensive system enhancements to capture the necessary data. Therefore, we believe further outreach is needed to make sure the information included is helpful to users of insurance entity financial statements before insurers are required to expend significant cost to comply with the requirements of the FASB ED.

We also believe that the FASB should reconsider presentation for reinsurance arrangements. Under the principles in in FASB ASC 410-30, *Asset Retirement and Environmental Obligations* (SOP 96-1, *Environmental Remediation Liabilities),* and FASB ASC 605-40, *Revenue Recognition – Gains and Losses* (FASB Interpretation 30, *Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets)*, related to presenting insurance recoveries in the same income statement line, we believe that recoveries pertaining to reinsurance contracts should be allowed to be presented net in direct losses on the statement of comprehensive income. Consistent with this concept, we also believe that premiums for reinsurance arrangements should be presented net, and disclosed in the notes to the financial statements by direct, assumed and ceded. We believe this presentation is appropriate as it provides a better understanding of the overall financial statements. We accept that permitting a net presentation may not entirely align other accounting guidance, but all the necessary details could be provided in the footnotes.

We are also concerned that presenting portfolios of insurance contracts separately as net insurance contract liabilities and net insurance contract assets would be very confusing to users of insurance entity financial statements. We recommend that all portfolios of insurance contracts be presented together, either as an asset or liability, and that the asset and liability positions be further detailed in the notes to the financial statements.

We recommend that during the upcoming roundtables, the FASB reach out to financial statement users to gather feedback on whether the proposed information is useful, and what other information could be displayed.

Transition: We support practical expedients being provided for transition, but have concerns that some of the practical expedients in the FASB ED will still require extensive work to obtain older information. Conceptually we do not believe that it is appropriate to require the margin at transition to be zero if it is impracticable to apply the guidance retrospectively or if there is no objective information that is reasonably available. We believe that the practical expedients provided in the IASB ED are more appropriate in allowing for hindsight.

We believe allowing entities to use a modified retrospective application as described in the IASB ED (allowing for the use of known activity to approximate historical information when it is impracticable to obtain), would allow for more consistent information and comparability

among financial statements as this will result in less situations with portfolios of insurance contracts with zero margins, and more verifiability of inputs.

We believe that the requirement in 834-10-65-1(j) of the FASB ED, for business combinations that occurred before the transition date, to determine the margin as of the original acquisition date by comparing the fair value of the asset and liability balances related to insurance contracts to the expected fulfillment cash flows may not be operational due to limitations on available past information. We recommend that the FASB consider allowing a practical expedient to permit entities to use hindsight in determining the expected fulfillment cash flows at the date of acquisition.

Our answers to the specific questions in the FASB ED provide more detail on the views expressed above and are attached in the Appendix to this letter. We have also attached as reference our comment letter to the IASB as an appendix to this letter.

Yours truly,

Richard Paul, Chair

Financial Reporting Executive Committee

Richard Lynch, Chair (2009 – 2013)

Insurance Expert Panel

Richard Sojkowski, Chair (2013 -2014)

Insurance Expert Panel

Appendix A

Response to Questions:
FASB Exposure Draft: *Insurance Contracts*

Scope

Question 1: Do you agree with the scope and the scope exclusions included in this proposed guidance, including its applicability to contracts written by noninsurance entities? If not, what types of contracts or transactions also should be included or excluded from the scope and why?

Yes, we agree that the guidance should apply to contracts that meet the definition of an insurance contract, and should not be based on the legal type of entity that may have issued the contract. However we are concerned that without modifications to the definition of an insurance contract, the population of arrangements that would be required to use the guidance would be too broad.

One area of concern is that the proposed scope includes arrangements that are predominantly based on credit risk as insurance contracts. We believe that the FASB should rethink how arrangements that are predominantly based on credit risk (for example standby letters of credit) be classified. We believe that contracts whose primary purpose is to provide the issuing entity with exposures to credit, that are not currently accounted for as insurance contracts, should be included in the financial instruments project. Including these products in the financial instruments project will allow for comparability of credit risk-related products within the banking industry. We also recommend that the FASB consider if changing accounting models for arrangements that are predominantly based on credit risk and are not currently accounted for as insurance contracts, would be appropriate from a cost benefit perspective.

Another area of concern is that the FASB ED indicates insurance must cover a pre-existing risk, and this concept is not well understood outside the insurance industry. We believe further clarification is needed to explain if a risk should or should not be considered a pre-existing risk and separated from an overall arrangement between two parties for the of assessing whether it is to be considered within the scope of the FASB ED.

We are also concerned with the lack of clarity in determining whether fixed-fee service contracts have the primary purpose of providing a service. While we agree with the scope exclusion for fixed-fee service contracts provided in 834-10-15-5 of the FASB ED, we request clarification in determining at what point a contract has the primary purpose of providing a service.

Therefore we recommend that the FASB reevaluate whether the definition of an insurance contract should be modified to avoid expanding the application of the guidance to contracts that should not be accounted for under the insurance contract guidance.

The FASB ED excludes retirement benefit obligations reported by defined benefit retirement plans that follow the guidance in FASB Topic 960. We recommend that this scope exception extend to health and welfare benefit plans (as defined within Topic 965), as these plans offer

postretirement and postemployment benefits as well as employer provided insurance benefits that are similar to insurance contracts. If these contracts are not excluded from the scope of the FASB ED, there would potentially be conflicting guidance for these plans to follow, as a health and welfare benefit plan would first look to Topic 965 for assistance.

We also request that the final guidance, in either the basis for conclusion or an example in the implementation guidance, clarify why defined contribution plans (as defined within Topic 962) are not specifically excluded from the scope. The benefits provided by defined contribution plans are limited to the balances accumulated in the individual participant accounts, with no further obligation or promise from the employer, and therefore would not need to be evaluated for significant insurance risk.

We strongly support the inclusion of examples in the implementation guidance of what products with guarantees meet or do not meet the definition of insurance contracts (834-10-55-40 of the FASB ED). We believe the current examples provide insufficient background about the arrangement to understand how the FASB decided whether or not the arrangement met the definition on an insurance contract or met the definition but was specifically scoped out. Therefore, we request more clarification of the descriptions of products (arrangement) and what obligates (e.g. own performance) the one party to compensate the other party. We are concerned that some of the answers on the examples provided in the FASB ED appear to be inconsistent with the framework of the proposed guidance. Members of the AICPA Depository Expert Panel and the Insurance Expert Panel would be happy to work with the FASB to enhance the examples to be included in the final guidance.

We also recommend that one additional column should be added to the chart in 834-10-55-40 of the FASB ED, to explain why the example meets or does not meet the criteria to be insurance. The way the chart is currently drafted it is unclear as to whether all of the scope exceptions have been considered in determining whether the examples are to be included in the scope.

Recognition

Question 2: Do you agree with the requirements included in this proposed Update for when noninsurance components of an insurance contract, including embedded derivatives, distinct investment components, and distinct performance obligations to provide goods or services, should be separately accounted for under other applicable Topics? If not, why?

Yes, we agree that is appropriate to separate certain components of an insurance contract when the noninsurance components are clearly separable from the insurance component.

Under the proposed guidance we are unclear and request clarification as to whether a distinct performance obligation to provide services (such as investment services), related to an investment component that is not separated from the insurance component should be separated.

We support the inclusion of examples (834-10-55-45 in the FASB ED) of how to apply the proposed guidance for separation of goods and services, but recommend that the final guidance include additional more realistic examples such as asset management services and roadside assistance coverage bundled with the sale of a car. We also request further explanation why the Stop-Loss and High Deductible Health Insurance Plan examples result in different conclusions when claims processing services are sold separately for both products.

Measurement Approaches

Question 5: Do you agree that entities should apply different approaches to contracts with different characteristics, described as the building block approach and the premium allocation approach? If not, which model do you think should apply and do you think there should be any changes made to that model?

Yes, we agree in theory that entities should apply different approaches (the building block and the premium allocation) to contracts with different characteristics.

However, we recommend that for contracts that would be required to apply the PAA, but that are managed with contracts accounted for under the BBA, entities should be permitted to apply the BBA to all the related contracts. Some insurance entities may wish to apply the BBA to all insurance contracts managed together for ease of administration and consistency in presentation. Entities would also be required to disclose this election.

Question 6: Do you agree that entities should be required to apply the premium allocation approach if the coverage period of the insurance contract, considering the contract boundary guidance, is one year or less? If not, what would you recommend and why?

As noted above in our response to Question 5, we believe that entities should be permitted to apply the BBA to all related contracts that are managed together for ease of administration and consistency in presentation.

Question 7: Do you agree that entities should be required to apply the premium allocation approach if at contract inception, it is unlikely that during the period before a claim is incurred there will be significant variability in the expected value of the net cash flows required to fulfill the contract? If not, what do you recommend and why?

As noted above in our response to Question 5, we believe that entities should be permitted to apply the BBA to all related contracts that are managed together for ease of administration and consistency in presentation.

We request that the FASB provide clarification as to whether the assessment for significant variability in the expected value of the net cash flows required to fulfill the contract should be made on a nominal basis or present value basis. The proposed guidance appears to use different definitions of expected value throughout the document.

We also request clarification as to what level should the determination of not expecting significant variability be made, the contract or portfolio level?

834-10-30-2 of the FASB ED defines expected value as the present value of the unbiased, probability-weighted estimate of the future cash outflows less the future cash inflows. While 834-10-55-54 of the FASB ED discusses that the expected value is that statistical mean of the full range of possible outcomes. We request clarification as to whether the expected value inherently includes the time value of money, or if that is a separate step to consider after the expected value is determined.

Question 8: Do you agree with definition of a portfolio of insurance contracts as included in this proposed guidance? If not, what do you recommend and why?

Currently there is diversity in U.S. GAAP with respect to how entities aggregate contracts for measurement resulting in difficulty for users in comparing financial statements. While we agree that the definition of a portfolio of insurance contracts should be addressed in the final guidance, we do not agree with the definition included in the FASB ED.

We strongly recommend that the FASB and IASB converge on this issue, as differences in the definition of a portfolio of insurance contracts will result in significant reporting complications for multinational entities. The definition of a portfolio of insurance contracts as defined in the IASB ED, that takes into account how entities manage their business, is more appropriate. The proposed definition of an overall portfolio of insurance contracts in the FASB ED may require a more granular level of portfolios than how entities manage their business and may not be justifiable from a cost benefit perspective.

We also believe that for certain measurement amounts it may be necessary to group insurance contracts into a smaller unit of account than the portfolio. For example, when determining the discount rate and margin, and unlocking the margin. We recommend that the final guidance acknowledge that different groupings would be permitted.

Fulfillment Cash Flows

Question 10: Do you agree with the types of cash flows that would be included in the measurement of the fulfillment cash flows, including embedded options and guarantees related to the insurance coverage under the existing insurance contract that are not separated and accounted for as embedded derivatives? If not, what cash flows do you think also should be included or excluded and why?

We also request that the FASB and the IASB strive for convergence on accounting for qualifying acquisition costs as a component of the margin or included as part of fulfillment cash flows. We believe that this is a fundamental difference that will make comparability among U.S. and international insurance entities unnecessarily difficult.

In determining what should be included as part of fulfillment cash flows; we request clarification as to what is meant by trail commissions as discussed in 834-10-55-104 of the

FASB ED. We question if the inclusion of trail commissions in 834-10-55-104 of the FASB ED, includes any trail commissions, even those commissions that are level. Based on the examples included in 834-10-55-104 and 55-153 of the FASB ED, it is unclear if ultimate level commission should be included as qualifying acquisition costs or included as part of fulfillment cash flows?

Question 11: Do you agree that the assumptions used in the measurement of the fulfillment cash flows should be updated each reporting period? If not, what do you recommend and why?

Yes, we agree that assumptions used in the measurement of the fulfillment cash flows should be updated each reporting period.

Question 12: Do you agree that the fulfillment cash flows for contracts measured using the building block approach and the liability for incurred claims for contracts measured using the premium allocation approach should be based on explicit, unbiased, and probability-weighted estimates (that is, the mean) of the future cash flows, as of the reporting date, expected to arise as the entity fulfills the contract, adjusted to reflect any contractual linkage between the contract and any underlying assets? If not, what do you recommend?

We are concerned that using fulfillment cash flows (the present value of the explicit, unbiased and probability-weighted estimates of the future cash flows) as defined in the FASB ED would not include a measurement for the uncertainty related to the allocation of probable outcomes, and may not accurately reflect the measurement of the insurance liability.

We believe that both the BBA and PAA should include the principle that there is uncertainty in cash flows. There is diversity among the various individuals within the AICPA group that compiled this letter regarding how the uncertainty should be included in the measurement models. There are various ways that uncertainty could be captured in both approaches such as; an explicit or implicit risk adjustment, or the amortization of the margin or premium over the coverage and settlement period.

We also request further clarification as to the unbiased measurement of cash flows and the interaction with probability-weighted estimates. It could be inferred that the use of probability-weighted estimates implicitly includes the use of management bias, to determine the weightings. We recommend that the final guidance further elaborate on what judgments are allowable and still considered unbiased.

Specifically we believe uncertainty is not fully included in the PAA, as the premium is amortized only over the coverage period and the liability for incurred claims is discounted. We recommend that the FASB reconsider how to include uncertainty in the cash flows.

Question 13: Do you agree with the approach in this proposed guidance to recognize changes in estimates of cash flows (other than the effect of changes in the liability arising from changes in the discount rate) in net income in the period? If not, what do you recommend?

No, for the BBA we believe that changes in estimates of future cash flows, which are related to future coverages or services, should be recognized as adjustments to the margin instead of in net income. The original amount included in the margin is an estimate of future expectations, and we do not believe it is appropriate to recognize further refinements of the estimate for the future cash flows in net income.

We believe recognizing estimates of future cash flows and changes to future expectations of those estimates both in the margin will result in more relevant measure of unearned profit in the financial statements.

In other standards under US GAAP, information is included to help differentiate between changes in estimates related to current and future cash flows. Therefore we recommend that the FASB should consider utilizing existing guidance, and include clarification in the final guidance, for how to differentiate between changes in estimates related to current and future cash flows.

Under the PAA, we request that the final guidance clarify that changes in estimated premiums (for example, changes in provisional premiums in workers compensation due to changes in head count) related to the remaining coverage should also be included as an adjustment to the liability for remaining coverage.

Question 14: Do you agree that the discount rates used by the entity for nonparticipating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

Yes we agree that the discount rates used by the entity for nonparticipating contracts should reflect the characteristics of the insurance contract liability.

Question 15: For contracts measured using the premium allocation approach, do you agree that an entity should discount the liability for incurred claims? Do you agree that entities should be allowed to elect not to discount portfolios when the incurred claims are expected to be paid within one year of the insured event? Why or why not? If not, what would recommend and why?

FinREC believes that the time value of money is relevant for the measurement of liabilities. We believe that incorporating discounting into the BBA or PAA approaches should be done in conjunction with incorporating the principle that there is uncertainty related to the allocation of probable outcomes in cash flows.

As discussed in our response to Question 12, we believe that both the BBA and PAA should include the principle that there is uncertainty in cash flows. There is diversity among the various individuals within the AICPA group that compiled this letter regarding how the uncertainty should be included in the measurement models. There are various ways that uncertainty could be captured in both approaches such as; an explicit or implicit risk adjustment, or the amortization of the margin or premium over the coverage and settlement period.

Specifically we believe uncertainty is not fully included in the PAA, as the premium is amortized only over the coverage period and the liability for incurred claims is discounted. We recommend that the FASB reconsider how to include uncertainty in the cash flows.

We also believe that entities should be allowed to elect not to discount portfolios when substantially all the incurred claims are expected to be paid within one year of the insured event.

Question 16: Do you agree that an entity should segregate the effects of underwriting performance from the effects of changes in discount rates (which would reverse over time) by recognizing changes in the present value of the fulfillment cash flows due to changes in the discount rates in other comprehensive income? If not, do you think that the effect of changes in the discount rates should be presented in net income? Please explain your reasoning.

No, while we agree that an entity should separately present the effects of underwriting performance from the effects of changes in discount rates, we do not agree that changes in the present value of the fulfillment cash flows due to changes in the discount rates should be required to be included in other comprehensive income due to the potential accounting mismatches and resulting volatility in earnings.

We believe that an entity should be allowed to make an accounting policy decision in an attempt to mitigate volatility in earnings (similar to the fair value option) in regards to whether changes in discount rates should be recognized in other comprehensive income or net income. We believe that this election should be consistent with any final decisions on the fair value election under the FASB's project on financial instruments.

Question 17: Because this proposed Update includes the approach that changes in the insurance liability arising from changes in the discount rates should be reported in Other Comprehensive Income, do you think that a test should be required to trigger recognition in net income of some of all of the amounts in accumulated other comprehensive income (i.e., a loss recognition test based on asset-liability mismatches)? Why or why not?

As noted in our response to Question 16, we believe that changes in discount rates should not be required to be reported in other comprehensive income.

No, we do not believe it would be appropriate to include a test to determine loss recognition in net income of some or all of the amounts in accumulated other comprehensive income. We believe that allowing entities to elect the appropriate accounting for changes in discount rates in conjunction with financial asset classification would help to eliminate asset-liability mismatches.

Question 18: Do you agree that the method for calculating the discount rates should not be prescribed? Is the guidance on determining the discount rates understandable and operational? Are the two approaches described sufficient? If not, what do you recommend.

Yes, we agree that the method for calculating the discount rate should not be prescribed.

If the requirement to discount the liability for incurred claims is included in the final guidance, we believe that for simplicity, entities should have the option to elect, and make an accounting policy decision, to apply a risk free rate or other practical expedient as a discount rate for insurance contracts accounted for under the PAA.

Question 19: Do you believe that interest expense generally should be based on the discount rates determined at the date the portfolio of contracts was initially recognized? Why or why not? If not, what do you recommend?

We believe that the discount rate for measurement under the BBA should be the inception portfolio discount rate. We also believe that the final guidance should acknowledge that entities should have flexibility in determining the inception portfolio discount rate. Specifically, permitting an average rate for calendar year or, if elected average for a quarter.

With regard to the discount rate for the liability for incurred claims under the PAA, we believe most insurers maintain their actuarial data on an incurred claim basis, and allocating IBNR amounts between policies with different inception dates would require significant costs to implement. Therefore, we recommend that entities be able to elect to either discount the liability based on the incurred discount rate or inception discount rates, as the impact of using either basis should not have a significant impact since the coverage period for most contracts under the PAA will likely be one year contracts.

Margin for Contracts Measured Using the Building Block Approach

Question 21: Do you agree that an insurer should not recognize a gain at initial recognition of an insurance contract (such a gain would arise when the expected present value of the cash outflows is less than the expected present value of the cash inflows), but rather should defer this amount as profit to be recognized in the future? Why or why not?

Yes, we agree with the principle that an insurer should not recognize any gain at initial recognition of an insurance contract.

Question 22: Do you support using a one-margin approach, as is included in this proposed guidance, or an explicit risk adjustment and a contractual service margin (as the IASB proposes)? Please explain the reason(s) for your view.

As discussed in our response to Question 12, some are concerned that using fulfillment cash flows without including a measurement for the uncertainty related to the allocation of probable outcomes, may not accurately reflect the measurement of the insurance liability.

Question 23: if you support a risk adjustment and a contractual service margin, do you agree with the IASB's approach to adjust the contractual service margin for changes in estimates of cash flows? Why or why not? Do you agree with the IASB's approach to not specify acceptable approaches to determining the risk adjustment? Why or why not.

Yes, we believe it is appropriate to adjust the contractual service margin for changes in estimates of cash flows which are related to future coverages or services. We agree that changes in estimates of future cash flows that do not relate to future coverage and other future services should be recognized immediately in net income.

If the FASB utilizes a risk adjustment, we believe it is conceptually consistent to reflect changes in uncertainty related to future cash flows through the contractual service margin.

Yes, we agree that the measurement of the risk adjustment should be based on an objective and not specific acceptable approaches, because using required approaches effectively results in a mechanical process to add an amount to the estimate.

Question 24: Do you agree that a loss at initial recognition of a portfolio of insurance contracts should be recognized immediately in net income (such a loss would arise when the expected present value of the future cash outflows exceeds the expected present value of future cash inflows)? Why or why not?

Yes, we agree a loss at initial recognition of a portfolio of insurance contracts should be recognized immediately.

As noted in our response to Question 8, while we agree that the definition of a portfolio of insurance contracts should be addressed in the final guidance, we do not agree with the definition included in the FASB ED. We strongly recommend that the FASB and IASB converge on this issue, as differences in the definition of a portfolio of insurance contracts will result in significant reporting complications for multinational entities. The definition of a portfolio of insurance contracts as defined in the IASB ED, that takes into account how entities manage their business, is more appropriate.

We also believe that for certain measurement amounts it may be necessary to group insurance contracts into a smaller unit of account than the portfolio. For example, when determining the discount rate and margin, and unlocking the margin. We recommend that the final guidance acknowledge that different groupings would be permitted.

Question 25: Do you agree with the proposed method(s) of recognizing the margin (that is, as the entity is released from risk under the insurance contracts as evidenced by a reduction in the variability of cash outflows)? If not, what do you suggest and why?

We agree that it is appropriate to use a principle to determine the release from risk as evidenced by a reduction in the variability of cash outflows, but are also aware that the use of this principle may result in a lack of consistency of financial statements.

We request clarification as to the intent of wording in 834-10-55-141 of the FASB ED:

> *An entity's methodology used to determine release from risk for each portfolio should be applied consistently throughout the lifecycle of the portfolio.*

We are unable to determine from the proposal when an entity changes its methodology used to determine release from risk because they have been able to obtain better information to determine when they are released from risk, would that change be considered a change in accounting principle or a change in estimate similar to updating information for fair value estimates? We believe such a change should be a change in estimate but the proposal can be read to imply that such a change is a change in accounting principle.

We also request clarification on the wording in 834-10-30-21 and 35-21 of the FASB ED, related to how to do the mechanics for determining the amounts of qualifying acquisition costs to be included in the margin. We recommend that the paragraph be rewritten as the current text is confusing to apply.

Acquisition Costs

Question 28: Do you agree that the direct acquisition costs considered in the measurement of the margin should include only the costs directly related to the entity's selling efforts that result in obtaining the contracts in the portfolio and that all other acquisition costs should be recognized as expenses when incurred? If not, what do you recommend?

We request that the FASB and the IASB strive for convergence on what qualifies as acquisition costs, as we believe it will be confusing to users of financial statements. However we believe that costs for unsuccessful efforts should not be included as acquisition costs.

We also request clarification as to how changes in estimates of qualifying acquisition costs, that are considered in the measurement of the margin for contracts under the BBA or the liability for remaining coverage for contracts under the PAA , should be treated. We believe the intention of the FASB is to have any changes in estimates of qualifying acquisition costs be treated as an adjustment to the margin or the liability for remaining coverage as appropriate. However this is not clear as currently drafted, and we request it be clarified in the final guidance.

As discussed in our response to Question 13, we believe that changes in estimates of future cash flows that impact qualifying acquisition costs, which are related to future coverages or services, should be recognized as adjustments to the margin or the liability for remaining coverage instead of in net income. Under the PAA, we request that the final guidance clarify that changes in estimated premiums (for example, changes in provisional premiums in workers compensation due to changes in head count) related to the remaining coverage should also be included as an adjustment to the liability for remaining coverage.

Also as discussed in our response to Question 10, we request clarification as to what is meant by trail commissions as discussed in 834-10-55-104 of the FASB ED. Based on the examples included in 834-10-55-104 and 55-153 of the FASB ED, it is unclear if ultimate level commission can be included as qualifying acquisition costs or included as part of fulfillment cash flows?

We also believe that entities should be allowed to elect to account for direct acquisition costs for contracts under the PAA, under either the proposed insurance contracts model, the proposed revenue recognition model (incremental acquisition costs) or to expense all costs. For some entities (mainly property and casualty insurance entities) the minimal benefits of including all direct acquisition costs would not outweigh the extensive costs to perform documentation of activities and the related updating of systems to capture the necessary information. Entities would be required to disclose their accounting policy election.

Question 29: Do you agree that the measurement of the margin for contracts measured using the building block approach and the liability for remaining coverage for contracts measured using the premium allocation approach should be reduced for direct acquisition costs paid? If not, what do you recommend?

We request that the FASB and the IASB strive for convergence on accounting for acquisition costs paid either as a reduction to the margin or included as part of fulfillment cash flows. We believe that this is a fundamental difference that will make comparability among U.S. and international insurance entities unnecessarily difficult.

As noted in our response to Question 28, we also request clarification as to how changes in estimates of qualifying acquisition costs, that are considered in the measurements of the margin, should be treated. We believe it would be appropriate to have any changes in estimates of qualifying acquisition costs be treated as an adjustment to the margin or the liability for remaining coverage as appropriate.

Question 30: Do you agree that an entity should recognize acquisition costs as an expense in the statement of comprehensive income in the same pattern that it recognizes the margin for contracts measured using the building block approach or in the same pattern that it reduces the liability for remaining coverage under the premium allocation approach? If not, why not?

We agree that acquisition costs should be recognized as an expense in the statement of comprehensive income in the same pattern as the margin is recognized for contracts measured using the building block approach or in the same pattern that the liability for remaining coverage under the premium allocation approach is reduced.

Insurance Contract Revenue

Question 31: Do you agree that users of financial statements would obtain relevant information that faithfully represents the entity's financial position and performance if, for all insurance contracts, in the statement of comprehensive income an entity presents insurance contract revenue and incurred expenses, rather than information about changes in margin (that is, the net profit)? If not, why?

Although we believe it is better to present insurance contract revenue and incurred expenses in the statement of comprehensive income rather than only changes in the margin, we are concerned that the current proposed presentation approach may not provide users with a relevant financial measure.

Question 32: Do you agree that, for all contracts, revenue should exclude any amounts received that an entity is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs, and that expenses should exclude the corresponding repayment of those amounts? If not, what do you recommend? Please specific whether your view depends on the type of contract.

We agree that, for all contracts, revenue should exclude any amounts received that an entity is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs, and that expenses should exclude the corresponding repayment of those amounts.

Question 33: For contracts measured using the premium allocation approach, do you agree that an entity should adjust the liability for remaining coverage to reflect the time value of money, and recognize the accretion of interest with insurance revenue, if the contract has a financing component that is significant to the contract? Do you agree with the practical expedient that an entity should not be required to reflect the time value of money in measuring the liability for remaining coverage (that is, if the entity expects, at contract inception, that the time period between the payment by the policyholder of all or substantially all of the premium and the entity providing the corresponding part of the coverage is one year of less)? If not, what would you recommend and why?

We agree that the liability for remaining coverage should be adjusted to reflect the time value of money if the contract has a financing component that is significant to the contract. We also agree with the practical expedient that an entity should not be required to reflect the time value of money in measuring the liability for remaining coverage if the time period between the payment by the policyholder of the premium and the entity providing the coverage is one year or less.

Question 34: For contracts measured using the building block approach, does this proposed Update contain sufficient guidance on how to determine insurance contract revenue in accordance with the principle that it should be allocated between reporting periods as performance obligations are satisfied over time (that is, to allocate consideration between periods by reference to the relative value of the services provided in each period)? If not, explain what additional guidance is necessary.

As noted in our response to Question 31, we are concerned that the current proposed presentation approach may not provide users with a relevant financial measure.

If the FASB continues with the proposed model, we believe that the implementation guidance provided in the FASB ED on how to determine insurance contract revenue is helpful, but request that the final standard include additional information on the principle related to how to determine the relative value of service provided plus the implementation guidance.

Participating Contracts

Question 35: Do you agree that participation features contractually dependent on the performance of other assets or liabilities of the insurer or the performance of the entity itself should be measured on the same basis used to measure the underlying items and changes in the measurement should be presented in the same statements (that is, net income or other comprehensive income)? Do you agree that this should be limited to only participating features for which the amount of the performance of the underlying items passed through to policyholders is contractually determined and not extended to participating features that allow an entity discretion regarding the amount of the performance of the underlying item to pass through to the policyholders? If not, what do you recommend and why?

Yes, we agree that participation features that are contractually dependent on the performance of other assets or liabilities of the insurer or the performance of the entity should be measured on the same basis used to measure the underlying items. We also agree that changes in the measurement should be presented in the same statements.

We do not believe that participating features that allow entity discretion regarding the amount of the performance of the underlying items to pass through to the policyholders should be measured on the same basis used to measure the underlying items, since the performance of the underlying item may not be fully passed through to the policyholder.

However, we believe the proposals in the FASB ED and the IASB ED relating to contracts with participating features are complex and difficult both to understand and to apply consistently. We believe the FASB and IASB need to clearly define an overall principle in accounting for contracts with participating features and to reconsider various aspects of the proposals for contracts that have a linkage to, or vary with, underlying items.

We recommend that the final standard provide clarification in the implementation guidance to explain how these concepts apply to a variety of U.S. contracts (for example, universal life contracts, deferred fixed annuity contracts, mutual participating contracts, “closed block” participating contracts, and group pension contracts).

Reinsurance

Question 36: Do you agree that a cedant should record a margin if the expected present value of the cedant's future cash inflows exceed the expected present value of the cedant's future cash outflows (thus prohibiting the recognition of a gain at inception upon entering into a reinsurance arrangement) for (a) retrospective reinsurance contracts accounted for using either the building block approach or the premium allocation approach and (b) prospective reinsurance contracts accounted for using the building block approach? If not, what do you recommend and why?

We agree that a cedant should record a margin if the expected present value of the cedant's future cash inflows exceed the expected present value of the cedant's future cash outflows (thus prohibiting the recognition of a gain at inception upon entering into a reinsurance arrangement) for (a) retrospective reinsurance contracts accounted for using either the building block approach or the premium allocation approach and (b) prospective reinsurance contracts accounted for using the building block approach.

Question 37: Do you agree that a cedant should estimate the fulfillment cash flows (including the ceded premium) for a reinsurance contract using assumptions consistent with those used to measure the corresponding (part of the) fulfillment cash flows for the underlying insurance contract or contracts, without reference to the margin on the underlying contracts? If not, what would you recommend and why?

We agree that a cedant should estimate the fulfillment cash flows (including the ceded premium) for a reinsurance contract using assumptions consistent with those used to measure the corresponding (part of the) fulfillment cash flows for the underlying insurance contract or contracts, without reference to the margin on the underlying contracts.

Business Combinations

Question 38: Do you agree that entities should record a loss at the acquisition date in the amount by which any excess of the asset and liability balances related to insurance contracts measured in accordance with the guidance in this proposed Update exceeds the fair value of those assets and liabilities? Do you agree that entities should record a margin (not an immediate gain) for the amount that the fair value of the asset and liability balances exceeds those assets and liabilities measured in accordance with the guidance in this proposed Update? If not, do you think an entity should instead increase or decrease goodwill for the differences between the fair value and the measurement in accordance with the guidance in this proposed Update on those assets and liabilities? Why or why not?

We do not agree that entities should record a loss at the acquisition date in the amount by which any excess of the asset and liability balances related to insurance contracts measured in accordance with the guidance in the FASB ED exceeds the fair value of those assets and liabilities.

We believe that the proposal in the FASB ED to recognize a loss at the acquisition date would be an overall exception to the principles in ASC 805, *Business Combinations*, that has not been thoroughly explained. If the FASB proceeds with the guidance proposed, we request further elaboration why such an exception would be appropriate for the acquisition of insurance contracts under a business combination.

Presentation

Question 40: Do you agree with the presentation requirements included in this proposed Update? If not, what would you recommend and why?

Although we believe it is better to present insurance contract revenue and incurred expenses in the statement of comprehensive income rather than only changes in the margin, we are concerned that the current proposed presentation approach may not provide users with a relevant financial measure.

We agree with the objective of providing volume information in the statement of comprehensive income for contracts under both the BBA and the PAA that aligns the underlying concepts with the principles outlined in the anticipated revenue recognition standard. However for insurance contracts under the BBA the period of time from inception until settlement can be for many years, and often decades, so following the principles under the proposed revenue recognition standard may not meet user needs and would require extensive system enhancements to capture the necessary data. Therefore, we believe further outreach is needed to make sure the information included is helpful to users of insurance entity financial statements before insurers are required to expend significant cost to comply with the requirements of the FASB ED.

We also believe that the FASB should reconsider presentation for reinsurance arrangements. Under the principles in FASB ASC 410-30, *Asset Retirement and Environmental Obligations* (SOP 96-1, *Environmental Remediation Liabilities),* and FASB ASC 605-40, *Revenue Recognition – Gains and Losses* (FASB Interpretation 30, *Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets)*, related to presenting insurance recoveries in the same income statement line, we believe that recoveries pertaining to reinsurance contracts should be allowed to be presented net in direct losses on the statement of comprehensive income. Consistent with this concept, we also believe that premiums for reinsurance arrangements should be presented net, and disclosed in the notes to the financial statements by direct, assumed and ceded. We believe this presentation is appropriate as it provides a better understanding of the financial statements. We accept that permitting a net presentation may not entirely align other accounting guidance, but all the necessary details could be provided in the footnotes.

We are also concerned that presenting portfolios of insurance contracts separately as net insurance contract liabilities and net insurance contract assets would be very confusing to users of insurance entity financial statements. We recommend that all portfolios of insurance contracts be presented together, either as an asset or liability, and that the asset and liability positions be further detailed in the notes to the financial statements.

We recommend that during the upcoming roundtables, the FASB reach out to financial statement users to gather feedback on whether the proposed information is useful, and what other information could be displayed.

Disclosures

Question 41: Do you agree with the disclosure requirements included in this proposed Update? If not, which disclosure requirements would you change and why? Are there any additional disclosures that would provide decision-useful information and why? Do you think that any of the disclosure requirements included in this proposed Update would not provide decision-useful information and should not be required? If so, which ones an why?

Yes, we agree with the proposed disclosure principle of including qualitative and quantitative information about the amounts recognized in the financial statements from insurance contracts, and the nature and extent of risks arising from insurance contracts, as this is useful information for users of financial statements.

The proposed disclosure requirements include many specific and detailed disclosures that we believe are excessive and will likely obscure the information that financial statement users will find necessary and useful. Specifically we are concerned that to comply with 834-10-50-31 of the FASB ED and provide sufficient detail to help users evaluate the sensitivity to insurance risks, would require detailed disclosures at the portfolio level.

Effective Date and Transition

Question 43: Do you think the effective date should be the same for both public and nonpublic entities? Do you think the effective date should be the same for regulated insurance entities and nonregulated insurance entities? Why or why not?

We believe that nonpublic entities should be granted additional time to adopt the final guidance, as this will be a significant undertaking of time and cost to adopt the new standard. However we believe that nonpublic entities that own public entities should be given the opportunity to early adopt at the same time as public entities. Otherwise some nonpublic parents would have to unwind the new accounting model and retain a dual basis longer, resulting in addition costs and complexities.

We believe that adopting this guidance could be a significant undertaking for noninsurance entities. We recommend that noninsurance entities be given the option to early adopt at the same time as public entities, but not be required to adopt until a later period.

Question 44: Do you agree that the practical expedients relating to transition included in this proposed guidance are sufficient for retrospective application (that is, are the transition provisions in this proposed guidance operational)? If not, what would you recommend and why?

We support practical expedients being provided for transition, but have concerns that some of the practical expedients in the FASB ED will still require extensive work to obtain older information.

Conceptually we do not believe that it is appropriate to require the margin at transition to be zero if it is impracticable to apply the guidance retrospectively or if there is no objective information that is reasonably available. We believe allowing entities to use a modified retrospective application as described in the IASB ED (allowing for the use of known activity to approximate historical information when it is impracticable to obtain), would allow for more consistent information and comparability among financial statements as this will result in less situations with portfolios of insurance contracts with zero margins, and more verifiability of inputs.

We also request 834-10-65-1f(3) of the FASB ED be revised, as it makes reference to the general requirements of FASB ASC 250-10 on retrospective application of accounting changes but does not correctly describe the requirements.

We believe it is helpful to include examples of objective information that could be used to determine the margin at transition (as included in 834-10-55-178 of the FASB ED).

Question 45: For business combinations that occurred before the transition date, is the requirement included in this proposed guidance on reallocating the fair value of the asset and liability balances related to insurance contracts between the expected fulfillment cash flows and the margin operational? Why or why not? If yes, what you recommend and why?

We believe that the requirement in 834-10-65-1(j) of the FASB ED, for business combinations that occurred before the transition date, to determine the margin as of the original acquisition date by comparing the fair value of the asset and liability balances related to insurance contracts to the expected fulfillment cash flows may not be operational due to limitations on available past information. We recommend that the FASB consider allowing a practical expedient to permit entities to use hindsight in determining the expected fulfillment cash flows at the date of acquisition.

We also recommend that the final guidance clarify that a transaction accounted for as a pooling of interest, should continue to follow the transition guidance applicable when the transaction was originally accounted for (no use of fair value).

We are also concerned with applying the transition requirements to arrangements with full coinsurance that are administered by a third party. In these situations the direct writer may not have access to the underlying data to determine the necessary information at transition, or even have the system to estimate. We recommend that the FASB consider developing a practical expedient for entities that have ceded entire contracts. One possibility is to have a zero margin and to use a current discount rate to allow for simplicity in making estimates at transition. Although the entity would still have to apply the existing requirements for evaluating the credit risk of the reinsurer.

We also recommend a practical expedient be provided for businesses disposed of through sale prior to the effective date of the final guidance. We do not believe that restating prior periods for businesses reported as discontinued operations will provide useful information to users. Furthermore, it would be extremely difficult, time-consuming and costly for preparers to restate prior periods, especially if the personnel and systems necessary to restate are no longer under the ownership or control of the preparer.

Question 46: Do you agree that the proposed approach to transition would provide users of financial statements with relevant information that faithfully represents the entity's financial position and performance in a way that appropriately balances comparability with verifiability? Why or why not?

We believe that allowing entities to use a modified retrospective application as described in the IASB ED (allowing for the use of known activity if impracticable), would allow for more consistent information and comparability among financial statements as this will result in less situations with entities with zero margins, and more verifiability of inputs.

Costs and Complexities

Question 47: Describe the nature of the incremental costs of adopting the guidance in this proposed Update, distinguishing between one-time costs and ongoing costs. Explain which aspects of the guidance in this proposed Update are driving those costs and include ideas to make the proposal more cost effective.

We are concerned about the cost of adopting the guidance for noninsurance entities, and recommend that the FASB performs a cost benefit analysis for noninsurance entities that may have arrangements that will be included in the final insurance standard.

Other:

The FASB ED changes the reference of the definition of insurance contract for defined contribution (FASB ASC 962-325-35- 7 through 8) and health and welfare plans (FASB ASC 965-325-35-3 through 5) to Topic 834, *Insurance Contracts,* from Topic 944, *Financial Services – Insurance.* We believe that these ASC sections are referring to investment contracts with insurance entities, and not to the insurance contracts addressed under this proposal. We recommend that these sections as well as FASB ASC 960-325-35-3 be updated to change the current terminology from "insurance contracts" to "investment contracts with insurance entities" to avoid confusion.

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Appendix B

November 27, 2013

International Accounting Standards Board
30 Cannon Street
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United Kingdom

Exposure Draft – *Insurance Contracts*

The Financial Reporting Executive Committee (FinREC) and the Insurance Expert Panel, both of the American Institute of Certified Public Accountants (AICPA), appreciate the opportunity to comment on the International Accounting Standards Board (IASB) Exposure Draft–*Insurance Contracts* ("IASB ED"). Additional input was also received by members of the AICPA Depository Institutions Expert Panel, Employee Benefit Plans Expert Panel and Health Care Expert Panel.

FinREC continues to support the efforts of both the Financial Accounting Standards Board (FASB) and the IASB to either converge or more closely align U.S. generally accepted accounting principles (U.S. GAAP) with the International Financial Reporting Standards (IFRS). However, as we have stated in previous letters, high quality accounting standards should not be sacrificed for the sake of convergence.

We also note that U.S. GAAP comprehensively addresses accounting for insurance contracts by insurance entities, whereas IFRSs do not have comprehensive insurance guidance. We acknowledge that the FASB may ultimately decide to only make targeted improvements to U.S.GAAP that may limit the extent the IASB and FASB could converge on accounting for insurance contracts.

We believe the key areas that the IASB and the FASB should seek convergence on are the following:

- Unlocking the Margin - changes in estimates of future cash flows, which are related to future coverages or services, should be recognized as adjustments to the margin (see our response to Question 13 of the FASB ED)
- Fulfillment Cash Flows –should include a measurement for the uncertainty related to the allocation of probable outcomes (see our response to Question 12 of the FASB ED)
- Definition of Portfolio - the definition of a portfolio of insurance contracts should take into account how entities manage their business (see our response to Question 8 of the FASB ED)
- Acquisition Costs - what qualifies as acquisition costs and the accounting for acquisition costs paid (see our responses to Questions 28 and 29 of the FASB ED)

- Transition – practical expedients should allow for the use of hindsight (see our response to Question 44 of the FASB ED)

Our comments in this letter have been prepared to provide feedback on the specific questions in the IASB ED, and the comments in our letter to the FASB on their Exposure Draft, *Insurance Contracts* ("FASB ED") have been prepared to provide feedback on the FASB ED. We have attached our comment letter on the FASB ED as an appendix to this letter.

We do not fully support the building block approach ("BBA") or the simplified approach as currently proposed or the proposed presentation of the models.

Included in our response to the specific questions we have provided suggestions on certain aspects of the proposed approaches. We would also suggest that the IASB consider the following observations specific to the IASB ED:

Scope: As discussed in our response to Question 1 of the FASB ED, we are concerned that without modifications to the definition of an insurance contract the population of arrangements that would be required to use the guidance would be too broad.

We believe contracts that apply insurance accounting guidance between the IASB standard and FASB standards should be as converged as reasonable possible. Therefore, we believe that prior to issuing a final standard, the IASB should reevaluate whether modifications should be made to either the definition of what qualifies as an insurance contact or scope, if the FASB decides to modify their definition or scope.

Portfolios: Currently there is diversity in U.S. GAAP with respect to how companies aggregate contracts for measurement resulting in difficulty in comparing financial statements. We believe that the IASB ED's definition of a portfolio of insurance is more appropriate as it takes into account how entities manage their business. We strongly recommend that the FASB and IASB converge on this issue, as differences in the definition of a portfolio of insurance contracts will result in significant reporting complications for multinational entities.

Risk Adjustment: We believe that the measurement approaches by both Boards should include the principle that there is uncertainty in cash flows related to the allocation of probable outcomes. There is diversity among the various individuals within the AICPA group that compiled this letter regarding how the uncertainty should be included in the measurement models.

Adjustments to the Contractual Service Margin and Risk Adjustment: We agree it is appropriate to adjust the contractual service margin for changes in estimates of cash flows which are related to future coverages or services. We believe it is conceptually consistent to reflect changes in uncertainty related to future cash flows through the contractual service margin.

Acquisition Costs: We request that the IASB and the FASB strive for convergence on what qualifies as acquisition costs, as we believe it will be confusing to users of financial statements if

only one standard setter permits costs related to unsuccessful efforts to qualify as an acquisition cost. We believe that costs for unsuccessful efforts should not be included as acquisition costs.

We also request that the Boards strive for convergence on accounting for qualifying acquisition costs as a component of the margin or included as part of fulfillment cash flows. We believe that this also is a fundamental difference that will make comparability among U.S. and international insurance entities unnecessarily difficult.

Participating Contracts: We believe the proposals in the IASB ED and the FASB ED relating to contracts with participating features are complex and difficult both to understand and to apply consistently. We believe the IASB and FASB need to clearly define an overall principle in accounting for contracts with participating features and to reconsider various aspects of the proposals for contracts that have a linkage to, or vary with, underlying items.

Mutual Entities: We do not agree that mutual entities that issue insurance contracts, that provide policyholders with the right to participate in the whole of any surplus of the issuing entity, should include all future payments on those contracts in insurance liabilities with zero equity. We agree with the proposal in the FASB ED that a mutual entity would treat as equity any appropriate amount of surplus that it does not have the obligation, or intention, to payout in fulfilling insurance contract obligations. We also agree that an entity not having any equity could be inconsistent with approaches discussed in the IASB discussion paper: *A Review of the Conceptual Framework for Financial Reporting.*

Transition: We support practical expedients being provided for transition, and believe that the practical expedients provided in the IASB ED are more appropriate in allowing for hindsight as compared to the practical expedients in the FASB ED. We also support allowing entities to use a modified retrospective application as described in the IASB ED (allowing for the use of known activity if obtaining historical information is impracticable).

Our answers to the specific questions in the IASB ED are attached in the Appendix to this letter. Please refer to our letter on the FASB ED for additional observations on the proposed measurement models.

Yours truly,

Richard Paul, Chair

Financial Reporting Executive Committee

Richard Lynch, Chair (2009 – 2013)
Insurance Expert Panel

Richard Sojkowski, Chair (2013 -2014)
Insurance Expert Panel

Appendix B

Response to Questions:
IASB Exposure Draft: *Insurance Contracts*

Question 1 – Adjusting the contractual service margin

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if:

a) **Differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and**
b) **Differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognized immediately in profit or loss?**

As discussed in our response to Question 23 of the FASB ED, we believe it is appropriate to adjust the contractual service margin for changes in estimates of cash flows which are in related to future coverages or services. We agree that changes in estimates of future cash flows that do not relate to future coverage and other future services should be recognized immediately in net income.

We believe it is conceptually consistent to reflect changes in uncertainty related to future cash flows through the contractual service margin.

We request clarification on how the contractual service margin should be accounted for if the margin goes to zero before the coverage period expires. Would it be allowable to reestablish the margin if there are additional differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services during the remaining coverage period? For example, should favourable changes in future cash flows directly increase the contractual service margin when the entity previously recognized losses in profit or loss because the adjustment to the contractual service margin was limited (i.e., cannot be negative). We believe that insurers should first reverse any previously recognized losses in profit or loss before re-instating the contractual service margin. This may increase complexity due to the need to track information, but we believe this accounting is more appropriate for financial statement users.

Question 2 – Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

If a contracts requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if the entity:

a) Measures the fulfillment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?

b) Measures the fulfillment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the draft Standard (i.e. Using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?

c) Recognize changes in the fulfillment cash flows as follows:

  i. Changes in fulfillment cash flows that are expected to vary directly with returns on the underlying items would be recognized in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;

  ii. Changes in the fulfillment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognized in profit or loss; and

  iii. Changes in the fulfillment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognized in profit or loss and in other comprehensive income in accordance with the general requirements of the draft Standard?

Why or why not? If not, what would you recommend and why?

As discussed in our response to Question 35 of the FASB ED, we believe that participation features that are contractually dependent on the performance of other assets or liabilities of the insurer or the performance of the entity should be measured on the same basis used to measure the underlying items. We also agree that changes in the measurement should be presented in the same statements.

We do not believe that participating features that allow entity discretion regarding the amount of the performance of the underlying items to pass through to the policyholders should be measured on the same basis used to measure the underlying items, since the performance of the underlying item may not be fully passed through to the policyholder.

However, we believe the proposals in the FASB ED and the IASB ED relating to contracts with participating features are complex and difficult both to understand and to apply consistently. We believe the FASB and IASB need to clearly define an overall principle in accounting for contracts with participating features and to reconsider various aspects of the proposals for contracts that have a linkage to, or vary with, underlying items.

Question 3 – Presentation of insurance contract revenue and expenses

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if, for all insurance contracts, an entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts?

Why or why not? If not, what would you recommend and why?

As discussed in our response to Question 40 of the FASB ED, although we believe it is better to present insurance contract revenue and incurred expenses in the statement of comprehensive income rather than only changes in the margin, we are concerned that the current proposed presentation approach may not provide users with a relevant financial measure.

We agree with the objective of providing volume information in the statement of comprehensive income for contracts under both the BBA and the PAA that aligns the underlying concepts with the principles outlined in the anticipated revenue recognition standard. However for insurance contracts under the BBA the period of time from inception until settlement can be for many years, and often decades, so following the principles under the proposed revenue recognition standard may not meet user needs and would require extensive system enhancements to capture the necessary data. Therefore, we believe further outreach is needed to make sure the information included is helpful to users of insurance entity financial statements before insurers are required to expend significant cost to comply with the requirements of the FASB ED.

We are also concerned that presenting portfolios of insurance contracts separately as net insurance contract liabilities and net insurance contract assets would be very confusing to users of insurance entity financial statements. We recommend that all portfolios of insurance contracts be presented together, either as an asset or liability, and that the asset and liability positions be further detailed in the notes to the financial statements.

We recommend that during the upcoming roundtables, the FASB reach out to financial statement users to gather feedback on whether the proposed information is useful and/or what other information could be displayed.

Question 4 – Interest expense in profit or loss

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:

a) **Recognizing, in profit or loss, the interest expense determined using the discount rates that applied at the date the contract was initially recognized. For cash flows that are expected to vary directly with returns on underlying items, the**

entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and

b) **Recognizing, in other comprehensive income, the difference between**
   i. **The carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and**
   ii. **The carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognized. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows.**

Why or why not? If not, what would you recommend and why?

As discussed in our response to Question 19 of the FASB ED, we believe that the discount rate for measurement under the BBA should be the inception portfolio discount rate. We also believe that the final guidance should acknowledge that entities should have flexibility in determining the inception portfolio discount rate. Specifically, permitting an average rate for calendar year or, if elected average for a quarter.

With regard to the discount rate for the liability for incurred claims under the PAA, we believe most insurers maintain their actuarial data on an incurred claim basis, and allocating IBNR amounts between policies with different inception dates would require significant costs to implement. Therefore, we recommend that entities be able to elect to either discount the liability based on the incurred discount rate or inception discount rates, as the impact of using either basis should not have a significant impact since the coverage period for most contracts under the PAA will likely be one year contracts.

As discussed in our response to Question 16 of the FASB ED, while we believe an entity should separately present the effects of underwriting performance from the effects of changes in discount rates, we do not believe that changes in the present value of the fulfillment cash flows due to changes in the discount rates should be required to be included in other comprehensive income due to the potential accounting mismatches and resulting volatility in earnings.

We believe that an entity should be allowed to make an accounting policy decision in an attempt to mitigate volatility in earnings (similar to the fair value option) in regards to whether changes in discount rates should be recognized in other comprehensive income or net income. We believe the fair value election guidance under the FASB's project on financial instruments would be an appropriate basis for developing guidance for an accounting policy decision of insurance contracts.

Question 5 – Effective date and transition

Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

Why or why not? If not, what would you suggest and why?

As discussed in our response to Question 44 to the FASB ED, we support the transition guidance in the IASB exposure draft that allows for the use of known activity when retrospectively applying the final standard.

Conceptually we do not believe that it is appropriate to require the margin at transition to be zero if it is impracticable to apply the guidance retrospectively or if there is no objective information that is reasonably available.