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

Ms. Leslie F. Seidman
Acting Chairman
Financial Accounting Standards Board
(FASB)
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

**Re: IASB Exposure Draft – *Insurance Contracts*
FASB Discussion Paper – *Preliminary Views on Insurance Contracts*
File Reference No. 1870-100**

Dear Sir David Tweedie and Ms. Leslie F. Seidman:

MetLife, Inc. (MetLife) appreciates the opportunity to provide comments on the IASB Exposure Draft-*Insurance Contracts* (the ED) and the FASB Discussion Paper-*Preliminary Views on Insurance Contracts* (the DP). MetLife is a leading global provider of individual and institutional life and property & casualty insurance, employee benefits and financial services. Recognizing the importance and significant ramifications of an insurance contracts standard, we have been participating in the IASB field testing project and have been proactively sharing our thoughts with members of the IASB and FASB (the Boards) and their staff.

MetLife continues to believe users and preparers would benefit substantially if all participants agree to a common, understandable set of accounting standards. We support FASB and IASB actions that align with that goal and result in accounting standards that best enhance users' comprehension of companies' financial information and decision-making processes. Although there are similarities between the approaches that the Boards have taken relating to the accounting for insurance contracts, key differences still remain. Likewise, there are fundamental differences between the principles developed by each of the Boards on financial instruments accounting, which must be considered together with an insurance contract accounting standard in order to create an insurance accounting model that is relevant and meaningful. Therefore, we strongly urge the FASB and IASB to redeliberate and resolve these key differences and issue/reissue an exposure draft that reflects a common view of recognizing and measuring insurance contracts.

We believe the fulfillment measurement model along with the summarized margin presentation approach currently advocated in the ED and the DP is a major change from the measurement and presentation approaches currently understood and widely accepted by users of insurance company financial statements. The proposed model and presentation approach will introduce volatility in earnings and do not reflect the underlying business model and economic reality, resulting in financial statements which will be difficult to explain, thereby diminishing their value to the users. We believe this would lead to the proliferation of non-GAAP measures among insurance entities to help them to disseminate information to the analysts and other users.

The following pages present our thoughts on the key areas of insurance contract accounting in the ED and DP as well as responses to specific questions raised in each of the documents.

We once again thank you for the opportunity to respond to your proposals and your consideration of our observations and comments. If you have any questions regarding the contents of this letter, please do not hesitate to contact me.

Sincerely,

A handwritten signature in blue ink, appearing to read "Peter M. Carlson". The signature is fluid and cursive, with a large initial "P" and "C".

Peter M. Carlson

cc: William J. Wheeler
Executive Vice President and
Chief Financial Officer

MetLife Views on Key Proposed IASB ED and FASB DP Guidance

MetLife supports the development of a single set of high quality global accounting standards that are relevant, understandable and representationally faithful for users of the financial statements. Accordingly, we are supportive of the convergence of accounting standards as proposed by the ED and the DP, which still contain significant divergent views.

In our view, the development of a single set of high quality global accounting standards should not be significantly dominated by any particular regulatory jurisdiction or region. Regulatory jurisdictions often have their own interpretations of accounting guidance as evidenced by various “prescribed practices” of U.S. insurance regulators and the proliferation of differences from pure IFRS by international regulators. The financial statement framework currently being developed by the Boards emphasizes that the objective of general purpose financial reporting is to provide relevant financial information about an enterprise that is useful to current and potential investors, analysts, creditors and other users. As those users evaluate and invest in an enterprise based on management’s business strategy, it is essential that the same should be considered in the accounting principles on recognition and measurement.

The statement of financial position reflects the assets and liabilities of an enterprise at a certain point of time. We believe financial assets presented in the statement of financial position can be monetized and therefore, generally should be reflected at fair value. On the other hand, many financial liabilities, including insurance liabilities, generally cannot be monetized. Therefore, except for derivatives, embedded derivatives and similar features, reflecting such liabilities at fair value or current value does not provide relevant information to the users of financial statements. We believe insurance contract liabilities should be measured based on the methods described under the subheading of *General Concept of Measurement* below.

The income statement should reflect the performance of an enterprise for a certain period based on its business model. In our opinion, including fair value changes of assets and liabilities in the income statement creates earnings volatility in the short term, and does not present meaningful information on the performance of the underlying business. Therefore, except for financial assets and liabilities that are actively traded or contain features such as optionality or leveraged capital market returns, fair value changes of assets and liabilities generally should not be included in the income statement.

In the sections that follow, we outline our observations and recommendations on how insurance contracts should be recognized and measured. In our opinion, the comments expressed below are consistent with the Boards’ proposed accounting framework and the basic concepts stated above. In addition, we have addressed our concerns with the current proposals under the IASB ED and the FASB DP in our responses to the questions that follow.

General Concept of Measurement

As we stated in our comment letter on the FASB Financial Instruments Exposure Draft, we reiterate our view that financial liabilities, except for derivatives, embedded derivatives and similar features, should be measured at amortized cost. Hence, we believe most insurance liabilities should be measured at amortized cost as well. If monetization of financial liabilities such as insurance liabilities is restricted (ability to settle/transfer), then gains and losses from changes in fair value of such liabilities is of little relevance to the users of financial statements.

In its Financial Instruments project, the IASB has also determined that amortized cost is an appropriate measurement objective for most financial instrument liabilities. Similarly, the revenue recognition model is essentially an amortized cost model. Given the decisions in the Financial Instruments and Revenue Recognition projects, we believe an amortized cost model is appropriate for most insurance contracts rather than the proposed fulfillment value model.

However, there are features within insurance contracts for which amortized cost may not be appropriate. Examples include embedded derivatives not closely related to the host and many features that are currently accounted for under U.S. GAAP based on guidance within ASC 944-20 and ASC 944-40 (formerly Statement of Position 03-1) such as guaranteed minimum death benefits and guaranteed minimum income benefits within variable annuities, and secondary guarantees on universal life contracts. The insurance liabilities for these features are closely linked to the capital market performance and hence are generally managed via capital market hedges. Therefore, these should be bifurcated and measured at fair value. This would be consistent with the IASB's decision for financial instrument liabilities, which would generally be at amortized cost with embedded derivatives bifurcated at fair value.

In addition, a fair value option for insurance liabilities should be permitted to mitigate accounting mismatches in situations for which the invested assets backing the liability would have to be held at fair value. This would be also consistent with the IASB's decision for financial instrument liabilities.

Building Blocks Approach

We agree with the concept of the building block approach, with suggested modifications as presented below. The cash flows of the building blocks should constitute a probability-weighted estimate of cash flows over reasonable scenarios. The interest rate, explicit or implicit, used in the pricing of the insurance contract, would be the appropriate discount rate as it reflects the characteristics of the liability. We support a single composite margin approach as it is simpler to apply and easier to understand.

If a two-margin approach is adopted, we believe that the risk adjustment should approximate the provision for adverse deviation from possible unfavorable outcomes. We believe that the current description of the risk adjustment in the ED which is the "*maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected*" is an exit value concept, which is not relevant in the measurement of insurance contract liabilities. The residual margin should be the factor to eliminate any gain at initial recognition.

Further, we believe the components of the building blocks should generally be locked in at inception, subject to periodic evaluation of liability adequacy.

The exhibit below helps illustrate our suggested model.

Building Blocks Suggested by MetLife		
 Insurance Liability (Premiums) 	<p>Composite Margin An amount to eliminate any gain at initial contract recognition that includes an implicit risk adjustment margin and residual margin (recognized in earnings over the coverage periods; not remeasured; interest not accreted).</p>	
	<p>Present Value of the Probability-Weighted Estimate of Net Cash Flows Over Reasonable Scenarios The net amount that the insurer expects to collect from premiums and pay out for claims, benefits and expenses, estimated using current information and discounted to reflect the time value of money. (The components of the building blocks are locked in at inception, subject to periodic evaluation of liability adequacy.)</p>	 Present Value of Cash Flows 

Discount Rate

We believe the interest rate, explicit or implicit, used in the pricing of an insurance contract would generally be the appropriate discount rate. This rate reflects the characteristics of the insurance contract liability that can be observed at the time of issuance. In the absence of any unusual investment or pricing decisions, this rate would likely be similar or identical to the expected earned rate on the assets backing the contract, net of expected default losses.

Consistent with an amortized cost model, we believe that the discount rate should be locked in at inception of the contract, except for adjustments needed to maintain consistency between the discount rate and the credited rate on contracts with participating features, or discretionary interest credits, or unit linked contracts.

Margins

We support the single composite margin approach proposed under the DP for long-duration contracts. We believe a single composite margin provides a simpler and more understandable approach to account for the difference between expected cash inflows and outflows. This approach does not involve the arbitrariness and subjectivity for measuring an explicit risk adjustment, and would be easier and less costly to apply. In addition, we agree with the FASB’s position in the DP that the single composite margin approach is more consistent with the allocated transaction price approach as contained in the proposed accounting standard update on revenue recognition.

If a two-margin approach is to be adopted, we believe the risk adjustment should reflect the inherent uncertainty related to relevant future cash flows that arise in fulfilling insurance obligations. In our view, the risk adjustment would approximate the provision for adverse deviation from possible unfavorable outcomes.

In addition, we do not agree that the techniques for estimating the risk adjustment should be limited to the three techniques proposed in the ED. First, the three prescribed techniques are so

different and can generate vastly dissimilar results on the same block of business making it difficult to achieve comparability among entities. Second, entities can generate significantly different results due to variances in parameters even if all entities uniformly applied one of the prescribed techniques. Third, the prescribed techniques may not be appropriate for calculating the risk adjustment for all existing and new products. There may be times when the calculations performed under the permitted techniques are demonstrably inappropriate. Finally, limiting the allowable techniques will only hinder future research into developing superior techniques. Therefore, we believe the Boards should only address the principle and augment that principle by providing some illustrative examples of the techniques. Insurers should be allowed to determine the most appropriate technique that best reflects the underlying uncertainty of cash flows for various products.

Unbundling

Under our suggested building block approach, components with optionality features and embedded derivatives within insurance contracts would be unbundled. Any further unbundling would be arbitrary and would not provide relevant information to the users of financial statements.

However, if the proposed fulfillment model is mandated, we believe that unbundling components of an insurance contract that are not closely related to the insurance coverage would be necessary to alleviate some of the issues caused by the discount rate mismatches in certain products and to more appropriately reflect the nature of the components. Therefore, unbundling components of an insurance contract under the current IASB Insurance Contracts and Financial Instruments projects would be beneficial to the users of financial statements by avoiding potential significant volatilities that do not reflect true economics of long-duration insurance contracts. This would ensure that elements of insurance contracts that have the characteristics of financial instruments covered by IFRS 9 and IAS 39 (and the FASB Exposure Draft on Financial Instruments) and/or service contracts covered by the Exposure Draft on Revenue Recognition will be accounted for as other financial instruments or service contracts.

In addition, we believe it is appropriate to expand the unbundling concept to all significant pre-funding of non-participating contracts. This would include cash values on non-participating whole life contracts, pre-funded amounts on long-term care contracts and disability income contracts, and the value of any term certain components of life contingent payout annuities (although we believe that the latter would be unbundled under the provisions of the ED). The unbundling of all significant pre-funding of non-participating contracts would allow significant pre-funding elements to be accounted for consistently with financial instruments and reduce the opportunity for structuring contracts to achieve accounting results.

Transition

Under our suggested approach, we do not foresee any significant issues with retrospective application at transition.

Based on our interaction with the members of both the Boards and staff, we understand that the Boards realize there are major issues with the current transition guidance proposed under the ED. We would like to reiterate that the current proposal of having no residual margin at the date of transition for inforce business will lead to a significant increase in equity upon transition and no recognition of profit in the income statement in future years subsequent to transition. This would not reflect the true economics of underlying inforce business and therefore, undermines the

usefulness of the income statement, especially for entities which have significant inforce business.

In our response to IASB ED Question 17, we proposed several practical approaches in estimating the residual margins on the inforce business for the Boards to consider.

Presentation

We believe the income statement should reflect the performance of an enterprise for a period of time based on its business model. In our view, the income statement should include premiums and fees (top line growth), benefits and claims (change in liabilities) and other expenses. These are key indicators that are used by management, industry analysts and investors to assess the performance of insurance enterprises.

The summarized margin presentation approach currently advocated in the ED and the DP is a major change from the presentation approaches currently being followed. Premiums have been regarded as a major indicator of growth among users and analysts. We believe that the recognition of premiums as deposits and claims, benefit payments and expenses as withdrawals would misrepresent the nature of the business. This would lead to the development of non-GAAP measures among entities to help them to disseminate relevant information to analysts and other users. Hence we believe there will be reduced reliance on the GAAP financial statements, thereby substantially diminishing their value.

Two-Model Approach

Under our framework, we believe the business models for long-duration and short-duration contracts are sufficiently different to warrant a two-model approach.

The building block approach is appropriate for long-duration insurance contracts. Incorporating the time value of money in long-duration contracts by using an appropriate discount rate ensures that the balance sheet reflects the true financial position as of the reporting date.

On the other hand, the time value of money may not be significant for short-duration contracts. Incorporating a discount rate would not provide any additional value to the users of financial statements. Also, for a typical short-duration contract, such as a standard property and casualty insurance contract, it is very difficult if not impossible to project any meaningful probability-weighted cash flows as both the timing and the extent of losses are uncertain.

We do not believe that the guidance should narrowly define short-duration contracts as having a coverage period of approximately one year or less. The unintended consequence of this restrictive brightline would result in contracts with identical terms and conditions exceeding the coverage period of little over 12 months being forced to be measured under the building block approach instead of the modified approach. Thus the determination of short- versus long-duration contracts should take into consideration the coverage duration as well as other characteristics such as guaranteed renewability of the contracts as is currently the guidance under U.S. GAAP. In our opinion, this current approach to classification of short- versus long-duration of insurance contracts works very well and has not been abused or caused any issues in application.

Conclusion

We believe our approach as presented above is consistent with the financial statement framework currently being developed by the Boards and provides relevant and decision-useful information to the users of financial statements. We summarize our thoughts below:

- Aligning discount rates for measuring insurance liabilities to the interest rates used in pricing of the products best reflects the characteristics of such liabilities.
- As insurance contracts cannot be monetized, an amortized cost model is appropriate for most insurance contract liabilities. Exceptions include derivatives, embedded derivatives and similar features within insurance contracts, for which a fair value model is appropriate.
- Gross presentation of premiums and claims is the most appropriate presentation on the income statement. The key indicators widely used and accepted by the investment community can be derived directly from the income statement under the gross presentation approach. We believe that, if a summarized margin approach is adopted, the income statement will otherwise be ignored in favor of the cash flow statements, the financial statement disclosures and other non-GAAP measures that will develop in practice.
- A two-model approach that properly reflects the business model of long- and short-duration contracts is appropriate.

However, if the Boards remain committed to a fulfillment model, we believe the Boards need to address the major concerns raised by the insurance industry as well as the analyst community. These include, but not limited to, discount rate, transition guidance, summarized margin approach, unbundling and explicit risk adjustment.

In addition, we believe that the IASB has not sufficiently considered the interaction between the proposals in the ED and IFRS 9. In our view, financial assets and insurance liabilities should be measured consistently in the income statement in order to prevent meaningless non-economic volatility in earnings.

Measurement mismatches and meaningless volatility would only add to the complexity in understanding financial performance and could result in divestments by current investors and disincentives for those contemplating investing in insurance enterprises. As stated above, this will certainly lead to proliferation of non-GAAP measures that users and preparers in the industry believe are better indicators of the true economics of the business. Insurance entities may be forced to withdraw products with long-term insurance guarantees, which cause the volatility in earnings. Lack of availability of such products would not be in the public's best interest. This would exacerbate the reasons for divestments and disincentives for investing in the insurance industry resulting in increased cost of capital and/or reduced capital availability for the industry. This in turn would result in a reduction in long-duration investments such as mortgages and real estate by insurance entities resulting in reduced capital available for such industries.

Again, we reiterate our support for the development of a single set of high quality global accounting standards that are relevant, understandable and representationally faithful for users of the financial statements. However, those global accounting standards should appropriately reflect the insurance business model.

Responses to ED and DP Questions

The following are MetLife's responses to questions raised in the ED and the DP. We have arranged the questions and responses by ED topic. The Appendix at the end of the letter cross references the ED and the DP questions. As indicated above, MetLife advocates an amortized cost approach for measuring insurance contracts except for certain features within such contracts. The responses below highlight our views on measuring insurance contracts under the fulfillment model approach currently proposed in the ED and the DP.

Relevant Information

IASB ED Question

01. Do you think that the proposed measurement model will produce relevant information that will help users of an insurer's financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why?

No. The proposed measurement model that is based on the current fulfillment value does not provide the users of financial statements with relevant, useful, understandable and representationally faithful information for economic-decision making.

Some key weaknesses of the proposed measurement model are:

- The discount rate proposed in the ED does not reflect (misrepresents) the actual economics in the valuation of the liabilities
- The concept of risk margin is arbitrary and subject to management's discretion

MetLife supports the Boards' effort to provide relevant and decision-useful information through one set of comprehensive guidance based on consistent recognition and measurement standards. There have been many discussions around separate measurement models for life and non-life insurance contracts. We believe the measurement model should take into consideration the duration of the risk. Hence, the measurement model should distinguish between short- and long-duration insurance contracts. However, the determination of short- and long-duration should be principle-based instead of rule-based.

Please refer to the individual ED questions that follow for more detailed discussions.

FASB DP Questions

20. Do both the building-block approach and the modified approach (with the latter approach applied only to certain short-duration contracts) produce relevant and decision-useful information? Why or why not?

Refer to the response to IASB ED Question 1.

22. Are there specific types of insurance contracts for which the approaches would not provide decision-useful information?

Refer to the response to IASB ED Question 1.

Fulfillment Cash Flows

IASB ED Questions

02(a). Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?

We do not agree primarily because we do not believe that current fulfillment value is an appropriate measurement objective for insurance contracts. Generally, long-duration insurance contracts are similar to financial instruments with the additional feature of pooling of risks. On the other hand, short-duration contracts are similar to service contracts covered by the Boards' Revenue Recognition project. In the Financial Instruments project, the IASB determined that amortized cost is an appropriate measurement objective for most financial instrument liabilities. We agree with the IASB on that point but, we also believe that a pooling of insurance risk feature should not make amortized cost inappropriate for insurance contracts. Similarly, the revenue recognition model is essentially an amortized cost model. Given the decisions in the Financial Instruments and Revenue Recognition projects, we believe an amortized cost model rather than any type of current value or fulfillment model is more appropriate for most insurance contracts as well.

An amortized cost model for insurance contracts may take several forms. Both the IASB and FASB have developed amortized cost models that could form an appropriate basis for an amortized cost model for insurance contracts. The liability model under U.S. GAAP FAS 60 would be one appropriate starting point under which cash flows would be locked in except for onerous contracts. The amortized cost model that the IASB exposed within its financial instruments model would be another appropriate starting point under which cash flows would be updated each period. Yet another approach would be the customer consideration model under the joint Revenue Recognition project. Regardless of the model chosen as a starting point, appropriate recognition would need to be made for common features within certain insurance contracts such as policyholder dividends, discretionary interest credits or unit-linked investment returns. For these features, the discount rate needs to remain in sync with the cash flows.

Although we believe that amortized cost is the appropriate model for most insurance contracts, there are features for which amortized cost is not appropriate. These features should be bifurcated and measured at fair value. Embedded derivatives that are not closely related to the host contract are one example of a feature that should be bifurcated and measured at fair value, consistent with the IASB's decision for financial instrument liabilities. But insurance contracts can have other features that should be bifurcated and measured at fair value – particularly features that would be embedded derivatives except that they are payable upon an insurable event. Examples would include many features covered under U.S. GAAP within ASC 944-20 and ASC 944-40 (formerly SOP 03-1), such as guaranteed minimum death benefits and guaranteed minimum income benefits within variable annuities, and secondary guarantees on universal life contracts. In our opinion, bifurcation and measurement at fair value of features such as optionality or leveraged capital market returns in insurance contracts is an appropriate principle. Other features for which fair value may be more appropriate are separate account balances within variable or unit-linked contracts. In addition, even if amortized cost is appropriate for the liability, a fair value option should be permitted to mitigate accounting mismatches in situations for which the invested assets backing the liability would have to be held at fair value, consistent with the IASB's decision for financial instrument liabilities.

We also believe that, although reinsurance ceded assets are financial assets, they should be held using a measurement approach consistent with insurance contract liabilities. While this would be a deviation from the approach taken in the Financial Instruments project, we believe this deviation is appropriate given the nature of reinsurance contracts, which are more similar to insurance liabilities than to financial assets.

For claim liabilities, we believe that current practice under U.S. GAAP FAS 60 has provided relevant and reliable information to users of financial statements and we believe that the IASB should take a similar approach. In particular, the model proposed in the ED will be speculative and unreliable for long-tailed claims.

02(b). Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?

We have concerns about the level of guidance provided for estimates of future cash flows under a current fulfillment value model. In particular, it is literally impossible to identify and probability weight all possible outcomes. We believe the Boards' intent is to require the use of unbiased statistical mean (i.e., expected value) cash flows. For some insurance contracts such as payout annuities, this objective can be achieved without the need to prescribe probability-weighted cash flows.

One additional point needs to be made with respect to probability-weighted (or statistical mean) cash flows. In some cases, it would not be appropriate to treat the cash flows and the discount rate as independent building blocks when the cash flows are dependent on interest scenarios. In such cases, the cash flow and discount rate objectives need to be combined as the mean of present value of future cash flows. This situation would occur when the contract contains embedded derivatives (or similar features) that are not unbundled, such as minimum interest guarantees. In that circumstance, the additional economic scenario dependent cash flows occur only in low interest rate scenarios. As such, according to financial pricing theory, in order to get an appropriate valuation, those cash flows need to be discounted at the low rates from the scenario that generated the cash flows, rather than the average rate over all scenarios (which is the initial yield curve). Discounting these excess cash flows at the average discount rate would understate the liability value. Similarly, if cash flows occur only under high interest scenarios, discounting those cash flows at a rate other than the rate that generated the cash flows would overstate the value of those cash flows and liabilities.

FASB DP Questions

07. Do you agree with the use of the probability-weighted estimate of net cash flows to measure insurance contracts? Does that approach faithfully represent the economics of insurance contracts? Is it an improvement over existing U.S. GAAP?

No. Refer to responses to IASB ED Questions 2(a) and 2(b) above.

11. Do you agree with the description of cash flows that should be included in the measurement of an insurance contract? Is the proposed guidance operational?

In general, we agree with the description of the cash flows to be included in the measurement of an insurance contract with the exception of acquisition costs, which is further addressed in IASB ED Question 7 (DP Questions 13 and 14). However, the proposed guidance will impose

significant operational challenges for the insurance industry. The estimation and calculation of probability-weighted cash flows at each reporting period will require significant investment in systems and will pose operational challenges for completion of periodic analysis within the reporting timeframes.

Discount Rate

IASB ED Question

03(a). Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

We do not inherently disagree with this objective as long as it is interpreted properly. Unfortunately, we do not believe the principle as stated has generally been interpreted properly and, therefore, we believe it needs to be restated or clarified.

The basic principle for time value of money expressed in Paragraph No. 30 of the ED is to use rates that reflect the characteristics of the insurance contract liability. Timing, liquidity and currency are examples of such characteristics but they are not the basic principle for the time value of money nor are they an exhaustive list of examples. For example, tax characteristics are not included in the list.

Generally, there are no observable market prices for insurance contracts in a liquid market since insurance contracts do not trade in such markets. However, the time of sale of an insurance contract, is the only point when the rate that reflects the characteristics of the liability can be observed, at least by the insurance company. Therefore, in absence of evidence to the contrary, the interest rate explicit (or implicit) in the price of the insurance contract should be considered the rate that reflects the characteristics of the insurance contract liability at the time of sale.

In the absence of unusual investment or pricing decisions, this rate would likely be similar or identical to the expected earned rate on the assets backing the contract, net of expected default losses. Although that rate would be similar to the expected asset earned rate, in most cases it would still be the rate that reflects the characteristics of the insurance contract liability. After all, the insurer is expecting to pass that rate to the policyholder as the credited rate on the insurance contract.

We note that in some cases the pricing may include a spread off the crediting rate as a profit charge. However, this profit charge is not an element of time value of money and it could be included in other elements of the contract. For example, instead of taking a spread off the credited rate, the insurer could take a separate percentage of reserve charge, or a percentage of mortality risk charge, or a dollar amount charge which may or may not vary over time. It would not be appropriate for two otherwise identical contracts to use a different discount rate just because one contract takes its profit charge as a spread off the credited rate while the other contract takes the same amount of profit charge but expresses the charge in a different manner, such as fees. Therefore, we believe that the rate prior to the reduction for the profit charge is the rate that represents the time value of money on a contract with the characteristics of insurance.

Consistent with an amortized cost model, we believe that the discount rate should be locked in at inception of the contract, except for adjustments needed to maintain consistency between the

discount rate and the credited rate on contracts with participating features, or discretionary interest credits, or unit-linked contracts.

However, the approach we recommend could be used within a current fulfillment model as well. In that case, the discount rate would be updated to reflect the interest rate used in pricing new insurance or reinsurance contracts with similar features. A day after the sale of the insurance contract, the approach to determine the interest rate that reflects the characteristics of the insurance contract liability should be consistent with the approach to determine the rate on the day of sale (except perhaps under rare circumstances). Of course, if market interest rates have moved the rate that reflects the characteristics of the insurance contract liability may move consistently. But that rate should be determined in a manner consistent with that on the day of sale. Again, in the absence of unusual pricing or investment activity, this rate is likely to continue to be the future expected earned rate but measured as of that new point in time. To the extent interest rates have moved in the interim, the asset fair values would have moved accordingly, and the expected earned rate from those assets would have changed appropriately to reflect the changed economic environment.

At all subsequent periods in time (except perhaps under rare circumstances), the interest rate that reflects the characteristics of the insurance contract liability should continue to be determined in a consistent manner, as there would be no evidence to support a rate determined in an inconsistent manner.

As noted above, there is a possibility of occasional unusual situations that would invalidate the presumption that the expected asset earned rate represents the rate that reflects the characteristics of the liability (for example, investing in junk bonds without a corresponding increase in the default assumption or underpricing the market to gain market share or overpricing the market to effectively leave a market). Therefore, it would not be appropriate to use the expected asset earned rate blindly as the insurance contract discount rate at all times. Indicators that the insurer's own expected asset earned rate is not consistent with the characteristics of the insurance contract liability would be if its prices are out of line with competitors' prices for similar products or if its prices are out of line with reinsurance prices for ceding similar risks. Indeed, since a reinsurance contract is an asset that can completely replicate the characteristics of the insurance contract liability, other than own credit, the interest rate (before any profit charges) that a reinsurer would credit at any point on a contract that reinsures similar risks is the best objective indicator of the discount rate that reflects the characteristics of the insurance contract liability. This rate is likely reflective of the rate the reinsurer would expect to earn on the assets backing the risk, net of expected defaults. However, since such reinsurance rates are rarely observable, in the absence of evidence to the contrary, the rebuttable presumption should be that the insurer's own expected earned rate, net of expected defaults, reflects the rate consistent with the characteristics of the insurance contract liability.¹

The interest rate that reflects the characteristics of the insurance contract liability would implicitly include an element of own credit. For a highly-rated and regulated insurance company, this own credit element on a fulfillment basis (as opposed to a fair value or risk neutral basis) would be very small and stable, since it would be measured based on the insurer's view of the potential default losses to the policyholder in the course of fulfilling the contract, and thus could perhaps be ignored. However, if it is necessary to exclude this own credit element from the discount rate, the own credit element should be calculated consistently with the principle stated in Paragraph

¹ See Reback, L. (September 2010), "Calculating Liquidity Premiums for Insurance Contracts", *Financial Reporter*, Issue 82, pp. 12-15, Society of Actuaries

No. 44 of the ED for non-performance in reinsurance contracts (i.e., “the cedant shall consider the risk of non-performance by the reinsurer on an expected value basis...”). In other words, the own credit would be the expected default on a fulfillment basis rather than an exit value based on financial market credit spreads. Applying this principle to the own credit of an insurer rated A or better would likely produce a discount rate reduction of 5 basis points or less².

An alternative approach would be using a high quality corporate bond index. Such a rate would be consistent with the pricing of many products and thus consistent with the characteristics of the insurance contract liabilities. This would provide a consistent approach to the discount rate across insurance companies and enhance comparability.

03(b). Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?

See response to 3(a) above. As noted, the liquidity premium (including any other discount rate items that represent characteristics of the liability other than those included in the risk free rate or own credit, such as taxes, - although there should be no need to measure each component separately) should be calibrated to the expected rates that would be received on a reinsurance contract that ceded all the cash flows of the liability. In most cases this would be best estimated by the insurer’s own expected earned rate, net of expected defaults, less the risk free rate (and as noted in response to 3(a) above, to the extent that rate as applied to the liability implicitly includes a small element of non-performance risk, that can be removed as well).

03(c). Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfillment cash flows should not reflect the risk of non-performance by the insurer?

No. See response to 3(a) above. On a fulfillment basis, we believe that the non-performance element within an insurance contract is very small and stable (i.e., the vast majority of any spread over risk free rates represents elements other than non-performance risk, such as illiquidity or tax status). Therefore, we do not think it makes much difference whether or not non-performance risk is included in the calculation.

FASB DP Question

12. Do you agree that the carrying amount of all insurance contracts should be discounted if the effect is material? Do you agree with the proposed guidance on the discount rate that should be used to measure the carrying amount of insurance contracts? If not, which discount rate should be used?

We agree that the carrying amount of all insurance contracts should be discounted if the effect is material. Refer to the responses to the IASB ED Question 3(a) through 3(c) for further comments on the discount rate.

² Life After Death: Moody's Examines Life Insurance Insolvency (April 1999), pp. 1-11, Moody's.

Risk Adjustment vs. Composite Margin

IASB ED Question

04. Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favors)? Please explain the reason(s) for your view.

For long-duration contracts, we support the single composite margin as FASB favors and do not believe a separate recognition of a risk adjustment and a residual margin is appropriate.

The ED proposes an explicit risk adjustment to be included in the measurement of an insurance liability. The IASB's approach to an explicit risk adjustment is based on the premise that an enterprise can measure the risk adjustment reliably. In the absence of any active market, the measurement of the risk adjustment becomes very subjective, and therefore is not comparable and decision-useful to financial statement users. Moreover, the ED proposed approach to measure the risk adjustment as "the maximum amount that the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected" resembles the exit value approach, which is inconsistent with the current fulfillment value model.

However, we believe a single composite margin provides a simpler and more understandable approach to account for the difference between expected cash inflows and outflows. It does not involve the arbitrariness and subjectivity for measuring an explicit risk adjustment, and it would be easier and less costly to apply. In addition, we agree with FASB's position in the DP that the single composite margin approach is more consistent with the allocated transaction price approach as contained in the proposed accounting standard update on revenue recognition.

For short-duration contracts, we do not agree with applying the building block approach to measure the insurance liabilities during the post-claim phase. In addition, we do not support an explicit risk adjustment approach. The proposed approach would involve more actuarial assumptions and judgments that are subjective and less comparable among the insurance entities.

We believe the claim liability measurement model under current U.S. GAAP is well developed and effective in communicating the potential loss exposure related to the underlying blocks of business written over time. For example, under current U.S. GAAP, the claim liabilities are supported by the data collected by the claim adjusters instead of relying solely on actuarial assumptions. The development of the reserves is illustrated in Schedule P in U.S. statutory reporting, which also provides additional information about the accuracy of the past liability valuations.

FASB DP Questions

10. Do you think that the risk adjustment margin would be comparable for entities that are exposed to similar risks?

No. Refer to the response to IASB ED Question 4.

15. Do you agree with the use of either the composite margin approach or two-margin approach to measure the net insurance contract? Does either approach faithfully represent the economics of insurance contracts? Is either approach an improvement over the measurement used in current U.S. GAAP?

We prefer the composite margin approach as proposed by the FASB DP. Refer to the response to the IASB ED Question 4.

Risk Adjustment

IASB ED Questions

05(a). Do you agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?

We do not support an explicit risk adjustment and residual margins approach. Currently, insurers can not be relieved of their risks from an insurance contract without obtaining approvals from the policyholders and regulators. A risk adjustment based on the maximum current settlement amount an insurer would rationally pay may not appropriately factor in the restriction from such approvals. We believe a risk adjustment should reflect the inherent uncertainty related to all relevant future cash flows that arise in fulfilling insurance obligations. Please refer to responses on IASB ED Question 4 for more details.

05(b). Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. Do you agree that these three techniques should be allowed, and no others? Why or why not? If not, what do you suggest and why?

No. We do not agree that the techniques for estimating risk adjustments should be limited to the three techniques proposed in the ED. The three prescribed techniques are so vastly different that they may create very dissimilar results between entities. In addition, entities could generate significantly varied results under any of the prescribed techniques due to differences in parameters, even if all entities used the same techniques.

First, limitations on the number of techniques are problematic for several reasons. There is no reason that these particular techniques are superior for the purpose of meeting the objective of the risk adjustment than other techniques. Within FAS 157 under US GAAP and the IASB's Fair Value project, the Boards have not artificially limited the techniques that can be used to estimate risk margins on Level 3 fair value estimates. For example, the Wang transform technique used for pricing risks is consistent with a cost of capital approach and can be implemented more efficiently than the cost of capital technique described in the application guidance. But this technique is precluded by the ED's strict definition of the cost of capital approach. For some products, a Wang transform technique can be used in lieu of a cost of capital technique and be calibrated directly to catastrophe bond prices. We see no reason why such a technique should be precluded.

Second, limiting the allowable techniques will hinder future research into developing superior techniques for current products and for future product types, for which the prescribed techniques

may not even be appropriate. It does not seem appropriate to preclude future techniques that have not been developed yet but which may be superior to existing techniques.

Finally, there may be times when the calculations performed under the permitted techniques may be demonstrably inappropriate. For example, if an insurer reinsures a block of business or issues catastrophe bonds on or near the reporting date, those transactions may provide objective evidence of the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected, which may at least partially contradict the result of the permitted risk adjustment calculation. We see no appropriate basis for requiring that such objective and available evidence be ignored in lieu of an arbitrary and artificially limited set of permitted techniques.

Therefore, we believe the Boards should only address the principle and may provide some examples of techniques. Insurers should be allowed to determine the most appropriate technique that best reflects the underlying uncertainty of cash flows for various products. The Boards could require disclosure of the technique used for transparency and comparability.

05(c). Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90(b)(i))? Why or why not?

As discussed in IASB ED Question 5(b), we do not support the prescribed methods for estimating risk adjustment. In addition, we do not believe disclosing the confidence level will provide decision-useful information. Paragraph No. B76 of the ED has clearly stated the usefulness of confidence level diminishes when the probability distribution is not statistically normal, which is often the case for insurance contracts.

05(d). Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (ie a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?

While we support the single composite margin approach, we agree that an insurer should measure the risk adjustment or the composite margin at a portfolio level of aggregation.

05(e). Is the application guidance in Appendix B on risk adjustments at the right level of detail? Do you have any comments on the guidance?

We disagree with guidance that provides the details of risk adjustment calculations. We reiterate that we believe the standards should only contain the principles for calculating the risk adjustments. Over time, existing methods may improve and/or new methods may develop which, could be more appropriate for calculating risk adjustments for existing and new products.

FASB DP Questions

08. Do you think that an entity's estimate of the net cash flows should include a risk adjustment margin?

Please refer to the discussion in response to IASB ED Question 5(a) above.

09. Is the objective of the risk adjustment margin understandable? If so, do you think that the techniques for estimating the risk adjustment margin (see paragraph 52(b)), faithfully represent the maximum amount that the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected?

No. Refer to the responses to the IASB ED Questions 5(a), 5(b), 5(c) and 5(e).

Residual/Composite Margin

IASB ED Questions

06(a). Do you agree that an insurer should not recognize any gain at initial recognition of an insurance contract (such a gain arises when the expected present value of the future cash outflows plus the risk adjustment is less than the expected present value of the future cash inflows)? Why or why not?

We agree that insurers should not recognize any gain at initial recognition of an insurance contract. Such gain, if any, should be recognized over the coverage period.

06(b). Do you agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognized immediately in profit or loss (such a loss arises when the expected present value of the future cash outflows plus the risk adjustment is more than the expected present value of future cash inflows)? Why or why not?

We agree that a loss at initial recognition of an insurance contract should be recognized immediately in profit or loss when the expected present value of the future cash outflows plus the risk adjustment surpasses the expected present value of future cash inflows.

06(c). Do you agree that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period? Why or why not? If not, what do you recommend and why?

We agree that the level of aggregation for the measurement of insurance contracts should be at a portfolio level and, within that portfolio, by similar date of inception of the contract and by similar coverage period.

06(d). Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why (see paragraphs 50 and BC125–BC129)?

As stated above, we do not support a separate residual margin. However, if the final insurance contract standard adopts the risk adjustment and residual margins approach, we would agree the residual margin should be released in a systematic way over the coverage period. Ideally, the residual margin would be released on the basis of passage of time, adjusted for any known seasonality patterns in benefits and claims. In addition, if the risk adjustment and residual margins approach is adopted, we urge the Boards to allow the residual margin to be adjusted to offset changes from the subsequent re-measurement of the fulfillment value. The residual margin is calculated based on the assumptions and estimates at inception of a contract. As these assumptions and estimates change over the term of the contract, it would be more appropriate to

unlock and adjust the residual margin to be consistent with the assumptions and estimates that best reflect the current economic environment. These adjustments to the residual margin could be favorable or unfavorable resulting from positive or adverse experience or assumption changes.

06(e). Do you agree with the proposed method(s) of releasing the composite margin, if the Board were to adopt the approach that includes such a margin (see the Appendix to the Basis for Conclusions)? Why or why not?

We disagree that the composite margin should be released over both the coverage and claims handling period. As discussed in IASB ED Question 6(d), we believe the margin should be released over the coverage period of an insurance contract. Insurance protection during the coverage period is the primary performance obligation of an insurance entity.

In addition, as we discussed in IASB ED Question 6(d), we urge the Boards to allow the composite margin to offset changes from the subsequent remeasurement of the fulfillment value. These adjustments to the composite margin could be favorable or unfavorable resulting from positive or adverse experience or assumption changes.

06(f). Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131–BC133)? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?

We do not agree that interest should be accreted on the residual margin. As discussed above, the risk and residual margin approach does not provide comparable and decision-useful information. Accrediting interest on the residual margin adds complexity without providing any benefit.

FASB DP Questions

16. Do you think that the composite margin should be recognized in earnings in subsequent periods using the ratio described in paragraph 83? If not, how would you recognize the composite margin in earnings?

We believe the composite margin should be recognized over the coverage period of an insurance contract. Refer to the response to IASB ED Question 6(e).

17. Do you agree that interest should not be accreted on the composite margin? Why or why not?

We agree.

Acquisition Costs

IASB ED Question

07(a). Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition costs should be recognized as expenses when incurred? Why or why not? If not, what do you recommend and why?

We agree that incremental acquisition costs should be included in the initial measurement of the insurance contract as cash outflows. However, we also believe the incremental acquisition costs should be measured at portfolio level instead of at individual contract level, in order to be consistent with other measurement models proposed within the ED.

FASB DP Questions

13. Do you think that acquisition costs should be included as one of the cash flows relating to the contract? If not, how would you account for acquisition costs?

We agree that acquisition costs should be included as one of the cash flows relating to the contract.

14. Do you agree that acquisition costs included in the cash flows used in the measurement of the insurance contract should be limited to those that are incremental at the individual contract level? If not, which acquisition costs, if any, would you include in the measurement of the insurance contract?

We believe the incremental acquisition costs should be measured at portfolio level instead of at individual contract level in order to be consistent with other elements of the measurement model proposed in the DP.

Premium Allocation Approach

IASB ED Question

08(a). Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?

We believe a modified measurement approach should be allowed for the pre-claim liabilities. However, in our opinion, the premium allocation method should not be the prescribed measurement model. As we stated in the forepart, we do not believe the time value of money is significant for these contracts or adds relevant decision-useful information to the users of financial statements. We believe any modified method should be allowed for both the pre-claim and post-claim periods. We reiterate that the current U.S. GAAP measurement model provides users with relevant, reliable and representationally faithful information.

08(b). Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?

As stated in 8(a), we do not agree with the proposed approach as it is overly complex with no added value to the users of financial statements. We believe the current U.S. GAAP model should be applied in both pre-claim and post-claim periods.

FASB DP Questions

18. Do you think that all insurance contracts should be recognized and measured using one approach or that some insurance contracts should be recognized and measured using an alternative approach (for example, the modified approach)? Why or why not?

We believe that an alternative approach should be used for short-duration contracts. For example, the time value of money may not be significant for short-duration contracts. Incorporating a discount rate would not provide any additional value to the users of financial statements. Also, for a typical short-duration contract such as a property and casualty, it is very difficult, if not impossible, to project any meaningful probability-weighted cash flows, as both the timing and the extent of losses are uncertain.

19. If an alternate approach is required for some insurance contracts, what recognition, measurement, and presentation provisions should be applied (including those items noted in paragraph 106)?

We support the measurement model and the disclosure requirements under current U.S. GAAP, which is the Unearned Premium Reserve approach.

21. How should the scope of insurance products for each approach be defined (for example, duration of coverage period, duration of claims payment period, or type of insurance)?

In our opinion, the scope of insurance products for each approach should be defined based on principle. We believe the business models for long-duration and short-duration contracts are sufficiently different, and therefore should be measured based on two different approaches.

We do not believe that the guidance should narrowly define short-duration contracts to have a coverage period of approximately one year or less. The unintended consequence of this restrictive brightline would result in contracts with identical terms and conditions exceeding the coverage period of little over 12 months, being forced to be measured under the three building block approach, instead of the modified approach. Thus, the determination of short- versus long-duration contracts should take into consideration the coverage duration as well as other characteristics, such as guaranteed renewability of the contracts.

Contract Boundary Principle

IASB ED Question

09. Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?

As a major provider of group insurance products, we are concerned with the interpretation and application of the proposed boundary principle. Certificates are issued to individuals covered under group contracts. Under the proposed guidance, it is not clear if the risks of those individual “policies” should be taken into account to define the contract boundary. In addition, group contracts are often priced well in advance of the coverage period. We believe that defining the commencement of an insurance contract based on insurer’s ability to set the price of a contract may result in the recognition of upfront losses on such contracts before the coverage period begins. Moreover, the locked in concept of residual or composite margin on group contracts may not provide the opportunity to true-up the residual or the composite margin based on the final tally of the individuals under group contracts when coverage actually begins. Accordingly this aspect needs to be clarified in the accounting guidance on the boundary and recognition.

Participating Features

IASB ED Question

10(a). Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?

We agree that the measurement of insurance contracts should include participating benefits on an expected present value basis. However, we do not agree that future policyholders should be taken into account in determining dividends as indicated in Paragraph No. B61(j). We do not believe future policyholders would be within the boundary of the contract.

10(b). Should financial instruments with discretionary participation features be within the scope of the IFRS on insurance contracts, or within the scope of the IASB’s financial instruments standards? Why?

We believe these contracts should not be included in the scope of the insurance contracts standard in that they are not insurance contracts by definition. These contracts should be within the scope of the IASB’s financial instruments standards and measured consistently with other similar financial instruments.

10(c). Do you agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contracts must participate with insurance contracts in the same pool of assets, company, fund or other entity? Why or why not? If not, what do you recommend and why?

As noted in comments to IASB ED Question 10(b) above, we disagree with including any contracts that do not transfer significant insurance risk within the proposed insurance contract standard. Therefore, we would not include investment contracts with discretionary participation features, whether or not such contracts participate in the same pool of assets in which insurance

contracts participate, in the scope of insurance contracts. Financial reporting for such investment contracts should be covered by the standards that apply to other investment contracts.

10(d). Paragraphs 64 and 65 modify some measurement proposals to make them suitable for financial instruments with discretionary participation features. Do you agree with those modifications? Why or why not? If not, what would you propose and why? Are any other modifications needed for these contracts?

As noted in comments to IASB ED Questions 10(b) and (c) above, we disagree with including investment contracts with discretionary participating features in the scope of the insurance contract ED. Therefore, we do not see a need for the provisions in Paragraphs Nos. 64 and 65, which are intended to fit certain investment contracts within the proposed standard for insurance contracts.

FASB DP Question

05. The Board's preliminary view is that participating investment contracts should not be accounted for within the proposed model for insurance contracts but, rather, should be included in the scope of the proposed model for accounting for financial instruments. Do you agree? Why or why not?

We agree. Please also refer to the responses to IASB ED Questions 10(b) and (c).

Definition and Scope

IASB ED Question

11(a). Do you agree with the definition of an insurance contract and related guidance, including the two changes summarized in paragraph BC191? If not, why not?

We agree.

11(b). Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?

We generally agree that self-insured contracts should be scoped out of the insurance contracts ED. However, we have the following concerns in the applying Paragraph No. B17 of the ED:

- i. As part of their compensation, employees of insurance entities get insurance coverage on their life and health. We are concerned that a narrow application of the guidance in B17 may exclude such contracts from being accounted for as insurance contracts, even though they are no different from any other contract to third party employees.
- ii. In some cases employee benefit plans, typically the defined benefit plans, subscribe to insurance contracts issued by insurance entities. Most often such contracts are annuities with investment in separate accounts. A strict application of the guidance under this paragraph may result in these types of contracts being scoped out of this ED.
- iii. We further request clarification on the application of this guidance to insurance contracts between affiliated entities. As an example, a corporate owned life insurance (COLI)

contract that is issued between subsidiaries may result in the contracts being scoped out of this ED at the subsidiary level as well.

11(c). Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?

We believe that financial guarantees as defined in IFRS should be within the scope of the guidance. Consistent with our proposed measurement approach stated in response 2(a), we believe that financial guarantee contracts would generally contain optionality or leveraged capital market returns and thus be measured at fair value through net income under our proposal.

However, we believe that guarantees issued between parents and subsidiaries, between entities under common control, or by a parent on behalf of a subsidiary should be excluded from the scope of this guidance. Incorporating such contracts within the scope of this ED could result in double counting of the liability, especially if the guarantee is issued by the parent to a third party on behalf of a subsidiary for a debt. Accordingly the Board's conclusions in Paragraph No. BC197 need to be revisited and clarified.

FASB DP Questions

01. Are the proposed definitions of *insurance contract* and *insurance risk* (including the related guidance) understandable and operational?

In our opinion both definitions are understandable and operational.

02. If the scope of the proposed guidance on insurance contracts is based on the definition of an insurance contract rather than on the type of entity issuing the contract, would financial reporting be improved?

We believe that scope of the proposed guidance for insurance contracts based on the definition of an insurance contract rather than the type of entity issuing the contract would improve financial reporting.

03. Do you agree with the proposed scope exclusions? Why or why not?

Refer to the response to IASB ED Question 11(b).

04. Should benefits that an employer provides to its employees that otherwise meet the definition of an insurance contract be within the scope of the proposed guidance? Why or why not?

Refer to the response to IASB ED Question 11(b).

Unbundling

IASB ED Question

12. Do you think it is appropriate to unbundle some components of an insurance contract? Do you agree with the proposed criteria for when this is required? Why or why not? If not, what alternative do you recommend and why?

Under the proposed model in the ED, we believe that the unbundling of components of an insurance contract that are not closely related to the insurance coverage is appropriate. We believe that unbundling of components of an insurance contract under the current IASB Insurance Contracts and Financial Instruments projects would be beneficial to the users of financial statements. This would ensure that elements of insurance contracts that have the characteristics of financial instruments covered by IFRS 9 and IAS 39 and/or service contracts covered by the Exposure Draft on Revenue Recognition will be accounted for like other financial instruments or service contracts. This will eliminate opportunities for structuring contracts to achieve accounting results.

In addition, we believe that unbundling will alleviate some of the issues caused by the discount rate mismatches in certain products. For example, if the account balance of a universal life (“UL”) type contract is unbundled, it would be accounted for as a financial instrument, and carried at amortized cost under the IASB’s Financial Instruments project with a fair value option permitted. Such an amortized cost model, presumably with the discount rate set consistently with the pricing rate, could significantly mitigate and in some cases eliminate the discount rate mismatch issue to the extent of the effected account balances.

Other elements in insurance contracts besides the account balance itself, including cost of insurance charges, expense charges, interest spreads, death claim expenses, and annuitization benefits (on fixed annuities), would still be subject to the general insurance contract measurement model and thus be exposed to the discount rate mismatch. The remaining insurance contract would be largely term insurance for UL and the small annuitization benefit for single premium deferred annuities, and so less susceptible to the discount rate mismatch. Overall, under the unbundling, a substantial portion of the UL-type contracts would in essence not be subject to the artificial discount rate mismatch. For this reason, we believe the unbundling of the account balance into a financial instrument would be cleaner and easier than splitting cash flows of the contract between asset-dependent and non-asset dependent cash flows under the discount rate requirement in the ED.

Therefore, we support unbundling when components are not closely related to the insurance coverage and would support expanding unbundling to all significant pre-funding of non-participating contracts, including cash values on non-participating whole life contracts, pre-funded amounts on long-term care contracts and disability income contracts, and the value of term certain annuities on life contingent payout annuities.

We note that, although the ED provides some examples of components that are not closely related to insurance coverage, it is not clear how the term “closely related” should be applied to other components such as policy loans and pre-funding balances of non-participating contracts as discussed in previous paragraph. Further clarification is needed to determine when and how unbundling should apply.

Moreover, Paragraph No. 8(a)(ii) of the ED infers that an account balance would be considered closely related to the insurance coverage if all investment performance of the underlying investment is passed on to the policyholder. For example, in case of a UL-type contract, that does not pass all investment performance to the policyholder, it is not clear whether the account balance in such contract should be unbundled.

We also note that Paragraph No. 9 of the ED states that the crediting rate used in determining the unbundled account balance should reflect a crediting rate after eliminating any cross-subsidy. We interpret this to mean that the crediting rate will be attributed to the financial instruments component (liabilities) and any spread between the earned rate and crediting rate would be attributed in the insurance contract. We believe additional clarification is required.

FASB DP Question

06. Do you support the approach for determining when non-insurance components of contracts should be unbundled? Why or why not?

Refer to the response to IASB ED Question 12.

Presentation

IASB ED Question

13(a). Will the proposed summarized margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?

No. We do not believe that the proposed summarized margin presentation will be useful to users of the financial statements. The margin approach does not present on the face of the income statement key indicators utilized by investors, analysts and other users, as well as management in analyzing the financials of an insurance company. Excluding premiums and fees (top line growth), benefits and claims (change in liabilities) and other expenses will significantly impair the usefulness of the income statement for financial statement users.

In addition, presentation of revenue and expenses as measures of performance would be consistent with other industries. We recommend premiums, fees, benefits and other expenses continue to be presented in the income statement.

13(b). Do you agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

Yes, we generally agree that an insurer should present all income and expenses arising from insurance contracts in profit and loss.

However, as we responded to the FASB Exposure Draft on Financial Instruments, we believe that financial assets should generally be presented at fair value with changes in fair value reported through Other Comprehensive Income. Accordingly, we believe that insurance contract liabilities should be measured at amortized cost in order to avoid misleading accounting mismatches in the income statement.

FASB DP Questions

28. The margin presentation approach highlights the changes in the insurance liability, rather than the current approach in U.S. GAAP, which presents, among other items, premium revenues, benefits paid, operating costs, and changes in loss estimates. Would this change improve your understanding of the performance of an entity that provides insurance (for some types of insurance or for all)? Please explain.

No. Refer to responses to IASB ED Questions 13(a) and (b).

29. Should insurance contracts measured under the building-block approach be presented using a margin presentation approach or a premium presentation approach that would require a true-up amount as described in paragraph 119 (for example, the written allocation presentation approach or the allocated premium presentation approach)?

As stated in the responses to IASB ED Questions 13(a) and (b), we support a premium presentation approach.

30. Should short- and long-duration (or nonlife and life) contracts be presented in a similar manner even if such contracts are measured under different approaches?

Yes. We agree that short- and long-duration (or nonlife and life) contracts should be presented in a similar manner even if such contracts are measured under different approaches.

Disclosures

IASB ED Question

14(a). Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

Yes. We agree with the overall principle that financial statement disclosures should help users understand the amount, timing and uncertainty of future cash flows arising from insurance contracts.

14(b). Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

As discussed in our response to IASB ED Question No. 13, we do not believe that the proposed summarized margin presentation will be useful to users of the financial statements. As we propose a gross presentation of premiums, fees, benefits and expenses, we believe the disclosure requirements should be tailored accordingly.

We believe certain disclosures, such as sensitivity to insurance risks in relation to its effect on profit or loss and equity, and sensitivity for each type of market risks, as proposed in the ED are overly complex and voluminous and may lead to confusion rather than clarity. In addition, certain detailed disclosures may reveal proprietary information.

14(c). Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

See comments to Question No. 14(b).

FASB DP Question

31. Do you agree with the proposed disclosures in the IASB's Exposure Draft? Why or why not? If not, what would you recommend and why?

Refer to the response to IASB ED Question No. 14.

Unit Linked Contracts

IASB ED Question

15. Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?

We agree with the proposals in the ED regarding presentation and accounting mismatch of unit-linked contracts.

Reinsurance

IASB ED Question

16(a). Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?

We believe that the general purpose of an impairment test is to ensure that an asset is not carried in the statement of financial position at an amount that exceeds its recoverable amount. Currently, under U.S. GAAP reinsurance recoverables are subject to an incurred loss model (the FAS 5 model codified in Topic ASC 450). Under the incurred loss model, credit losses are recognized only when those losses have been incurred when there is evidence that the losses are probable and estimable. However, the current proposal to incorporate the non-performance risk of the reinsurer shifts the focus to that of an expected loss model.

The most observable input for estimating expected credit losses on reinsurance is the credit default swap rate. However, as evidenced by the recent credit crisis, the spreads on an entity's credit default swap rate can be extremely volatile and have lead to significant fluctuations in liabilities that are measured at fair value under U.S. GAAP, which are not reflective of the expected losses on these instruments. Thus, credit default swap spreads are not appropriate for use within a fulfillment value model (as opposed to a fair value model). Moreover, application of observable inputs like credit default swaps are not representative of the risk of default of reinsurance recoverables given the fact that reinsurance recoverables typically have a higher priority in bankruptcy than general liabilities and are closer to policyholder obligations.

Using any other input would make the expected loss model more subjective than the incurred loss model since it would rely on the ceding entity's cash flow estimates. In addition, the resulting expected loss estimate is likely to be very small, since we do not believe that there have been any significant defaults on account of inability to pay in the life reinsurance industry worldwide. Furthermore, in most cases in the U.S. as required by state regulations, reinsurance to unauthorized reinsurers is sufficiently backed through collateral arrangements, funds withheld type arrangements or letters of credit, which would further minimize the possible credit losses on reinsurance. Hence we question the value in considering such non-performance risk in the expected cash flows from reinsurers.

16(b). Do you have any other comments on the reinsurance proposals?

We believe that the following aspects of reinsurance accounting need to be addressed and clarified:

- i. In the case of an inforce block, the residual margin, which is dependent upon interest rate scenarios at the time of reinsurance, will be different from that of a direct product. The direct product will have a locked in residual margin that relates to the periods in time when it was written. The impact of a current interest rate scenario on the residual margin on reinsurance contract may be higher or lower. Depending on the size of the block and the periods in which it was written, if the reinsurance contract results in a gain, it may create a huge income statement impact. In contrast, if there is a loss, a residual margin is established. In other words, a loss to the cedant from a reinsurance contract is deferred as a residual margin, but a gain is realized immediately. While the recognition of gain in the income statement and the establishment of residual margin in case of a loss works well when the cession under a coinsurance or quota share reinsurance contract is contemporaneous with new direct business, the impact on cessions of inforce blocks may be profound. The size of the inforce block and the interest rates on the reinsurance contract dates could create a huge residual margin/loss on such reinsurance contracts.
- ii. In the case of reinsurance of non proportional contracts, the attachment points related to the risk are different from the underlying direct business. Hence, the proposed guidance to defer the loss through a residual margin or recognize a gain may not be appropriate as there is no symmetry in the economics between the underlying direct business and the risks that are ceded.
- iii. Certain reinsurance agreements have features that could impact the timing of the cash flows, which could result in a different residual margin for the ceded business as compared to the direct business. For example, funds withheld arrangement is widely used as collateral by ceding entities. The funds withheld balances are settled on a periodic basis along with interest, which may be a specific rate or based on the performance of a specific portfolio of investments. The withholding and the interest amount may impact the timing of the cash flows at inception, especially in case of inforce block of business. In a funds withheld coinsurance or a quota share type of treaty, we are concerned that this may result in a difference in underwriting results between the direct and ceded business.

FASB DP Questions

26. The scope of the proposed guidance includes reinsurance contracts that an insurer issues or acquires. However, insurance contracts held directly by other policyholders would be excluded from the scope of the proposed guidance. Do you agree with this exclusion? Why or why not?

We agree with the exclusion. As the policyholders' intent is to protect themselves against losses as opposed to being in the business of insurance, applying this standard to policyholders will not be relevant and representationally faithful.

27. Should there be symmetry between the recognition and measurement of reinsurance contracts and the underlying contract ceded?

This depends on facts and circumstances. For proportional reinsurance, generally there should be symmetry between the recognition and measurement of reinsurance and the underlying contract ceded. For non-proportional reinsurance, symmetry is probably not appropriate.

Transition and Effective Date

IASB ED Question

17(a). Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?

Although we agree that the Boards should take into account the work and effort that would be involved in developing a residual margin on inforce business as of the effective date, we do not believe it is acceptable to understate the initial liability and future earnings by assuming a residual margin of zero. We believe that such an approach would misstate the financial statements of well established insurance enterprises for a prolonged period of time.

However, we agree that a practical approach is needed in order to estimate residual margins as of the transition date. We offer several approaches that would strike a better compromise between expedience and usefulness of the financial statements. We believe the approach that was rejected by the Boards (i.e., calibrating the residual margin upon transition to the liability net of related assets (such as DAC or VOBA) under existing U.S. GAAP or IFRS) would be appropriate. Although this would perpetuate the influence of existing U.S. GAAP/IFRS guidance to some extent, the future measurements would still reflect the cash flow, discount rate and risk adjustment features of the new model. Any business sold after the transition date would fully reflect the new model. We do not see why insurance contract liability measurement for inforce at transition based on a residual margin calibrated to existing U.S. GAAP/IFRS guidance would be any less representative than a residual margin of zero.

If the above approach remains unacceptable, there are others that could be used to develop a transition liability. For example, for contracts with significant future premiums, the residual margin on in-force business can be calibrated as of the transition date. Effectively, the residual margin on the transition date would be set equal to:

Present value of future premiums/inflows as of the transition date
Less: Present value of future outflows as of the transition date
Less: Risk adjustment as of the transition date.

Under the FASB approach, the composite margin upon transition would be set equal to present value of future premiums/inflows as of the transition date less present value of future outflows as of the transition date.

Arguably, this would overstate the residual margin since it would ignore the amount of residual margin that would have been amortized between a contract's issue date and the transition date. However, a simple adjustment can be made for this by estimating the expected future life of each contract or cohort using information that would be available as of the transition date from the projected cash flows.

The amount calculated above could then be multiplied by the ratio of:

$$\frac{\text{Remaining expected future life as of the transition date}}{\text{Remaining expected future life as of the transition date} + \text{duration of the contract or cohort as of the transition date}}$$

This ratio should approximate the amortization of residual margin that would have been incurred up to the transition date assuming amortization in proportion to time. Even though the resulting residual margin may not be identical to the residual margin that would be in effect had the proposed model been in place from inception of the contract, it is far more preferable than distorting the financial statements by excluding residual margins on all inforce business as of the transition date.

However, this approach may not be appropriate for single premium contracts in force as of the transition date or contracts with significantly limited future premiums as of the transition date. For such contracts (and for level premium contracts as well), a residual margin could be approximated based on similar contracts being sold as of the transition date. For example, if the company sells new contracts similar to the inforce contract, and the residual margin on new contracts is 10% of the present value of cash flows, that ratio could be used to approximate the residual margin on inforce contracts.

Some other practical expedients that could be made to generate a more representative liability measurement than the transition rules proposed in the ED include:

- i. Estimate residual margins as far back as practicable using reasonable practical expedients to estimate such margins. Under this approach, residual margins would not be required for business that was very old and for which data may be difficult to obtain. However, more recent business would have a residual margin.
- ii. Allow the residual margin to be calculated using economic and other assumptions as of the transition date. This approach avoids the need to determine assumptions that would have been made at earlier dates. This would avoid a major issue that makes calculating historical residual margins impractical. It has an advantage for comparability in that all companies would use assumptions as of a consistent date for business inforce as of the transition date.

17(b). If the Board were to adopt the composite margin approach favored by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?

Under the FASB's proposal, the composite margin at transition date for existing business would equate to the risk margin set forth in the IASB ED. Thus, as indicated in the response to Question 17(a), MetLife disagrees with FASB's tentative decision that the residual margin is excluded from the composite margin calculation for existing business upon transition. We believe the same approaches that would be appropriate for calibrating residual margins upon transition could be used to calibrate composite margins.

17(c). Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?

As insurers manage assets to align with insurance contract liabilities, we believe it is more effective to require insurers to adopt the Insurance Contracts and Financial Instruments simultaneously.

However, as we indicate in our response to IASB ED Question 17(d) below, we believe that a significant amount of time will be needed to implement the insurance contracts standard. Therefore, we encourage the Boards to delay the effective date of the Financial Instruments standard for insurance companies.

17(d). Please provide an estimate of how long insurers would require to adopt the proposed requirements.

Given the modeling that will be required for insurance contracts under the proposed guidance, the intricacy of the standards set forth, and the tremendous effort to be made in educating and training investors, preparers and auditors, we believe at least a three-year period for adoption would be required.

Other Comments

IASB ED Question

18. Do you have any other comments on the proposals in the exposure draft?

See cover letter and forepart of the letter.

Benefits and Costs

IASB ED Question

19. Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.

We share the Boards' objective of providing relevant and decision-useful information through a proposed single and consistent recognition and measurement standard and support a

comprehensive principles-based insurance contract standard. However, we strongly urge the Boards to consider the comments we have raised in this letter and perform extensive field testing and due diligence on the testing results.

We do, however, have the following concerns relating to the operational aspects of the ED and DP. The requirement to determine probability-weighted cash flows of all scenarios as part of the building block and the subsequent re-measurement on a quarterly basis will be a tremendous strain on both human and technological resources. In most cases, these quarterly re-measurements would only capture the impact of current economic assumptions such as interest rates, which could be very volatile but of little relevance to investors. As a result, we believe the costs to re-measure the liabilities on a quarterly basis outweighs the benefits. We suggest the use of reasonable scenarios and re-measurement on an annual basis to balance the cost and benefits.

FASB DP Question

25. What are the incremental costs of adopting the alternatives described in this Discussion Paper? Please separately describe one-time costs and ongoing costs.

Given the significant changes proposed in the ED and the DP, we believe companies will incur significant one-time and ongoing costs. For a global insurance company with a diverse portfolio of insurance products, we would not be surprised if the implementation cost exceeds a hundred million U.S. dollars.

Examples of one-time costs include:

- Analysis of data requirements to apply the proposed measurement guidance.
- Software and hardware to generate stochastic models.
- Development and sign-off on measurement models and related controls.
- Upstream and downstream system enhancements to accommodate financial statement presentation requirements.
- Effects on other business processes such as risk measurement, product design, asset/liability management, planning and forecasting, etc.
- Development of “non-GAAP” measures to reflect the true economics of the business.
- Education of associates.

Examples on ongoing costs include:

- System capacity/runtime expenses and human resources needed to meet reporting timeframes.
- Expenses associated with the required updating of assumptions.
- Additional resources needed to compile and analyze proposed disclosures.
- Additional resources needed to upgrade and maintain internal controls.

Additional FASB Questions

23. What are the implications of the recent U.S. healthcare reform to the application of the proposed contract boundary principle, including whether health insurance contracts written under the new reforms would meet the conditions in the proposed guidance to be accounted for under the modified approach?

As indicated in our response to the IASB ED Question 9, further clarification is needed regarding contract boundary in order to respond to this question.

24. What other changes should be considered to both improve and simplify U.S. GAAP for short- and long-duration insurance contracts?

Refer to the response to IASB ED Question 2.

32. After considering your views on the specific issues contained in this Discussion Paper and the IASB's Exposure Draft, what do you think would represent the most appropriate improvement to U.S. GAAP?

- a. Pursue an approach based on the IASB's Exposure Draft?
- b. Pursue an approach based on the IASB's Exposure Draft with some changes? Please explain those changes.
- c. Pursue an approach based on the Board's preliminary views in this Discussion Paper?
- d. Pursue an approach based on the Board's preliminary views in this Discussion Paper with some changes? Please explain those changes.
- e. Make targeted changes to address specific concerns about current U.S. GAAP (for example, items included in paragraph 7)? Please describe those changes.

We believe (e) above is the most appropriate improvement to U.S. GAAP. As a leading global life insurance company we have noted that the current insurance accounting guidance under U.S. GAAP has been effective, widely understood and used globally. Our suggested model described before takes that view but does add in some targeted changes as listed below:

- i. The scope of the insurance measurement and recognition model needs to cover insurance contracts rather than insurance enterprises.
- ii. An amortized cost type model should be applied for valuation of all insurance contracts including ones that are currently accounted for under U.S. GAAP FAS 97.
- iii. Certain insurance contract features like guaranteed minimum death benefits and guaranteed minimum income benefits within variable annuity contracts and secondary guarantees/no lapse guarantees in the universal life products should be measured using a fair value model to better reflect the nature of these benefits.
- iv. A fair value option should be permitted for contracts that would otherwise be at amortized cost if that would mitigate or eliminate an accounting mismatch.

Appendix

ED and DP Question Cross Reference

IASB ED		FASB DP
Question	Topic	Question
1	Relevant Information for Users	20, 22
2	Fulfillment Cash Flows	7, 11
3	Discount Rate	12
4	Risk Adjustment vs. Composite Margin	10, 15
5	Risk Adjustment	8, 9
6	Residual./Composite Margin	16, 17
7	Acquisition Costs	13, 14
8	Premium Allocation Approach	18, 19, 21
9	Contract Boundary Principle	
10	Participating Features	5
11	Definition and Scope	1, 2, 3, 4
12	Unbundling	6
13	Presentation	28, 29, 30
14	Disclosures	31
15	Unit Linked Contracts	
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19	Benefits and Costs	25
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