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To: FASB Directors & Insurance Contract Project Manager

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As someone who has spent the majority of his professional career involved in the insurance industry, I care deeply that the industry has an accounting model that is representative and usable for all interested parties. As such, I welcome the opportunity to share my comments regarding the FASB's recent exposure draft, Insurance Contracts (Topic 834) issued June 27, 2013. I have spent most of the past fourteen years as a sell-side equity research analyst covering non-life insurance at Goldman Sachs and, most recently, J.P. Morgan where I interacted with the professional equity investor/user base (mutual funds, pension funds, hedge funds, etc.). While I will elaborate below, in short, ***I believe the current proposal could have the unintended consequence of hurting investor users by making the industry more difficult to understand***. Current GAAP seems to work quite well for insurance, especially with respect to the non-life insurance sector. In an attempt to address a few issues with accounting for life insurance, namely FAS 60 and FAS 97, the new proposed accounting methodologies appear to complicate insurance accounting. How is this so? Investor users will likely become more dependent upon managements to understand "results". Actuarial practices that have long been used to establish reserves and measure performance will be deemphasized or impossible to calculate using the new accounting and resulting financial statements. In addition, insurance accounting, and, therefore, financial performance will become less comparable with the broader financial services industry under the proposal. When it comes to convergence, consistency with the financial sector is more important, in my view, than with the IFRS.

More specifically, I have three reservations about the proposed accounting for insurance contracts: First, period-to-period financial performance is likely to be increasingly volatile as short-term changes in a number of newly emphasized inputs are incorporated into quarterly and annual financial reports. The new model appears to assume that accurate market inputs exist for valuing insurance liabilities and are consistent between companies (which is incorrect, in my view). The new accounting also appears to be pro-cyclical in nature, especially for life insurance liabilities. Second, the underlying valuation of claims liabilities could become automated (e.g., reserve setting is using the statistical mode) rather than incorporating actuarial experience and judgment. In addition, companies will be asked to effectively guess at the valuations of liabilities from events that have not occurred (e.g., off-shore hurricanes). As a result, the quality of liability valuations is likely to suffer, while the volatility of reported liability increases at the same time (although not equally for all companies). Third, under the new proposal, it is difficult to calculate many historical performance measures such as combined ratio, return on premium, earnings, and return on equity due to changes in the measurement, definition, composition and to the presentation of the financial statements. As I read the exposure draft, I felt as though ***the proposed accounting was a foreign language I was trying to translate without the benefit of a Rosetta stone***. As a result, this new accounting "language" results in a number of unintended and irrational consequences, in my view. A few examples:

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- Sales, underwriting ratios, earnings, and ROE will be less reliable because the number of inputs embedded in the income statement will increase. Essentially, I perceive the income statement as becoming a series of Level 3 inputs (of questionable value and subject to greater volatility). In addition, changes in the recognition period of income could create increasing mismatches between earnings and the appropriate equity base with which one measures return on equity. ***An important, but unappreciated by-product of this proposal is that historical performance and valuation measurements may be rendered moot (metrics investors believe are valid)***.

- ***The volatility of financial results may not be reflective of underlying business or financial performance***. For example, companies would be forced to book losses from an offshore hurricane in the Gulf of Mexico on September 30 in 3Q financials and then reverse that loss in 4Q financials if it failed to make landfall. In addition, by using the statistical mean for setting reserves, if cash flows do not vary from modeled expectations, a product line with a narrow band of variability like auto could appear to have similar volatility with a product line with a wide band of variability like catastrophe reinsurance. ***I believe financial reporting could be less reliable under the new standard, not more***.

- ***In my view, insurance will be even less comparable to other financial companies because most other sectors retain cost- rather than fair value-accounting***. The “earnings” and “equity” of insurance companies would include a number of factors that are not embedded in the accounting of other financial institutions (e.g., the earnings from the investment component of a fixed annuity will be radically different from a CD and non-life liabilities will be discounted while bank liabilities will not). In addition, I question how reliable financial statements will be that include specific events that have not yet happened or may not happen at all. Given the changes in accounting also affect balance sheet valuations (as do changes in earnings patterns), investors will lose multiple barometers of financial health.

- ***The quality of management interactions will likely decrease as more time is spent explaining reported financial results than discussing underlying business, operation or strategy issues***. Investor reliance on Form 10-K and 10-Q to interpret quarterly earnings could increase as many of the factors driving results will be disclosures. Given the timing gap that exists between earnings and SEC filings (for most companies), investors will have less information with which to make investment decisions. Financial reporting season will also become more difficult as results are presented without supporting information. And forcing investors to read all the Form 10-Ks and 10-Qs for multiple companies in the same evening simply to judge whether interim “results” are reasonable is not practical. Meanwhile, the availability and variability/volatility of “accounting inputs” will make it difficult to model future performance and conduct trend analysis, in my view.

- ***Changes in fundamental factors do not necessarily have an intuitive impact on results***. For example, an increase in life expectancy may actually result in life insurance profit recognition falling because it takes longer to extinguish the policyholder liability. For non-life insurance contracts using the building block approach, simply increasing comfort in the mean estimate would increase earnings because the “risk margin” required at inception to reflect uncertainty is reduced. If a company expects $1000 of claims but my confidence in the estimate later increases, my earnings increase. If the company later expects $1100 of claims but with no increase in certainty, income would not change proportionately. ***It is difficult to get comfortable with financial performance when it appears neither intuitive nor reflects management’s views, let alone explain it to someone else***.

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- I even struggle with how the discount rate should be calculated and whether the rate should be consistent company-to-company. For example, if the discount rate is a company's asset rate, then rates will vary from company to company. If this is ultimately how the discount rate is set it would incentivize companies to be more aggressive investors (higher asset yield equals higher discount rate). The discount rate highlights the key problem, from my view, with this proposal—do investors want accounting to attempt to value cash flows (and cash flow variability) or do investors want accounting to present assets and liabilities/revenues and expenses clearly so that they can measure and assign their own independent value to nominal cash flows? In my experience, investors/users prefer to assign their own values to nominal cash flow.

I believe that current US GAAP works extremely well for insurance generally and especially well for non-life insurance. As a result, I struggle with the idea that this well-adopted, multinational accounting standard (by US and a number of large European insurers and also underpins much of Japanese GAAP) is being scrapped simply to address challenges with FAS 60 and FAS 97 (life insurance issues) and in an attempt to realize "convergence" with the IFRS. Rather than scrapping existing gap, ***I believe that a number of logical modifications to US GAAP exist that would be beneficial to users***. I do not believe current GAAP is perfect, but its benefits far outweigh, in my view, those that might be created by the new insurance contracts proposal. In terms of enhancements, I would highlight:

- Premium recognition could be made more consistent by forcing companies in severity driven lines with a seasonal component to recognize premium in relation to risk in a policy period rather than simply ratably over the year (e.g., property and catastrophe-related lines or homeowners in wind-exposed states). This would better match premiums with incurred losses (especially with respect to large claim events) in most quarterly periods and would reduce period-to-period equity swings resulting from disconnect between loss and revenue recognition (whether from outsized profit or outsized loss).

- Loss reserving should continue to be based on actuarial best-estimates. However, severity-driven products could be forced to hold IBNR until a majority of the policy period has been passed (e.g., losses reflect the expected annual outcome of an accident-year not actual experience until a majority of premium is recognized). In addition, discount rates for structured liabilities should be set consistently and utilize a risk-free rate since these reserves have increased payment certainty (e.g., worker compensation claims settled with annuities). I would also eliminate reserve discounting as part of the fair value of the balance sheet in purchase accounting to improve comparability of reserves, incurred losses, and investment income for acquirers and non-acquirers.

- I would improve the classification and recognition of investment income by distinguishing between revenue related to assets held for income and those held for capital appreciation. I would also propose segregating retained earnings and AOCI to reflect this distinction so that investors could better track the value added/subtracted by investing activities (putting aside the efficacy of AOCI). I would also allow the transfer of assets from capital appreciation to income to reflect that intent changes. This would also improve comparability of financial results across companies by eliminating mark-to-market from realized gains and losses (i.e., eliminate the trading designation).

- Disclosure improvements are needed, especially with respect to the asset classes and durations of investments; Schedule P should be a mandated under GAAP on a product basis (as it is under SAP); current and prior-year incurred (and potentially paid losses) should be a quarterly disclosure (if not provided on the face of the income statement), not just an annual one; and a balance sheet disclosure should be created that presents assets and liabilities at par, the difference between par and fair value, and fair value (however accountants define it), which could be accomplished without changing current GAAP practices.

- For life insurance, an industry in which I am not an expert, it would seem that the non-life model could be adapted (as it is for disability). A benefit would be that investors could better track and distinguish between current book and back-book profitably. In addition, FAS 60 and FAS 97 could be codified to minimize management discretion as well as allow for more specific measurement periods to reflect changes in retention, market performance, interest rates, etc. Simply standardizing how and when companies react to changes in fundamentals would create transparency as would additional disclosures on the resulting financial statement impacts

- Finally, I do not believe that one accounting model is appropriate for non-life, life, guaranty, and title insurance. From my experience, the industries are dramatically different and the business dynamics, strategies, and competitors have less overlap rather than more. Even companies that operate in multiple sectors tend to view those operations as distinct and manage each appropriately. I am concerned that the examples in the proposal do not seem to recognize this and appear incomplete in scope; the need to field-test this standard to determine its efficacy is another source of concern. I believe the industry would be better served by targeted solutions and leveraging what already works well in existing US GAAP.

In closing, I appreciate the opportunity to comment on the proposed accounting for insurance contracts, especially since many of my peers are precluded from participating in formal feedback mechanisms. As I mentioned in my opening, I care deeply that the industry has an accounting model that is representative and usable for all interested parties. ***Current GAAP already provides a sound accounting framework and should be enhanced, in my view***. I am more than willing to discuss the proposals further and in more detail.

Sincerely,

Matthew G. Heimermann