October 21, 2013

TECHNICAL DIRECTOR
FILE REFERENCE NO. 2013-290
FINANCIAL ACCOUNTING STANDARDS BOARD
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Dear Technical Director:

I am writing to comment on the proposed Accounting Standards Update, Insurance Contracts *(Topic 834)*. ACUITY is a $3 billion property and casualty (P&C) insurance company; the proposed guidance most relevant to us would be the Premium Allocation Approach (PAA) since our insurance contracts are 12 months or less. The PAA's use of unearned premium and losses and loss adjustment expenses incurred is consistent with the current Generally Accepted Accounting Principles (GAAP) practices we employ today. However, the additional requirements in the proposal 1) for entities to measure their liabilities for incurred claims as the probability-weighted expected amount of cash outflows (the mean) and further 2) to reflect the time value of money through the discounting of reserves will be a significant change for us and for many, if not most, of our peers. We respectfully disagree that these two provisions are necessary; in fact, we feel strongly that neither should be implemented and explain our reasons below.

The practice of setting insurance reserves is very complex and highly uncertain. It requires sound actuarial judgment as well as an intimate knowledge of the company's business operations and circumstances. While not a GAAP pronouncement, significant current guidance for setting insurance reserves exists in the National Association of Insurance Commissioner's (NAIC's) Statement of Statutory Accounting Principle (SSAP) 55 and is used by insurance companies, whether GAAP reporters or statutory reporters, for establishing reserves. Considerable guidance is further contained in Actuarial Standard of Practice (ASOP) 43 Property/Casualty Unpaid Claim Estimates and ASOP 36 Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Reserves.

SSAP 55 describes the various analytical techniques used to estimate reserves in order to ultimately choose what management feels is the 'best estimate' to be recorded in its financial statements. SSAP 55 states specifically that it is anticipated that the 'midpoint' (or mean) in a range will be applicable *only* when there is a continuous range of possible values, and no amount within that range is any more probable than any other. The SSAP notes that "*in the rare instances* when,

after considering the relative probability of the points within management's estimated range, it is determined that no point within management's estimate of the range is a better estimate than any other point, the midpoint within management's estimate of the range shall be accrued."

Likewise, ASOP 43 provides guidance to actuaries in estimating unpaid liabilities for losses and loss adjustment expenses while ASOP 36 provides guidance to the appointed actuary in preparing a Statement of Actuarial Opinion (SAO). The SAO is a mandatory annual filing by all insurance companies in states where they do business to certify that the reserves make a reasonable provision for the company's unpaid obligations under the terms of its contracts and agreements in accordance with the laws of their state of domicile and in accordance with generally accepted actuarial standards and principles.

Over the years, the insurance industry has thoughtfully and comprehensively considered how to establish reserves within reasonable ranges and how to choose 'management's best estimate'. Insurance is unique in that a consumer pays premium today for a promise by the company to fulfill a future obligation. The amount and timing of this future obligation may not be determined for many years. It is because of this uncertainty that the professional practice and process for establishing insurance loss reserves exists. It is the means by which an insurance company ensures they are managing that uncertainty while at the same time making a reasonable provision for its obligations to ensure adequate resources exist to fulfill its promises. As the unique insurance considerations described here demonstrate, the process for responsibly setting reserves is not and should never be a formula, except perhaps in the simplest of circumstances or where more certainty surrounding ultimate fulfillment is known.

The proposal, regarding its change in the *calculation* of reserves to a more formulaic approach requiring a statistical 'mean', states that it will be more 'representationally faithful' and is expected to 'enhance consistency and comparability' because it would 'mitigate estimation bias'. None of these terms are defined in the proposal nor is an explanation given as to why the new process using the mean will produce more accurate or complete information concerning the company's estimate of what it expects to pay in the future for losses already incurred. The proposal appears to disregard existing guidance for setting reserves despite the fact that it has been established, approved and accepted by the actuarial profession (and others) and time-tested over many years. There is no proven or defined benefit to be achieved from the proposal's change in the calculation of reserves; however, there will be a significant cost on the part of insurance companies to change their process and procedures including reconciling to the current method (which is still required at this point for statutory filings with a company's state of domicile).

Also, while the additional requirement to discount reserves appears to make sense from a theoretical point of view, as previously mentioned, insurance reserves are very complex and highly uncertain. Recording reserves at full value versus a lower discounted value provides a hedge of conservatism for the users of the financial statements. If reserves when set are ultimately determined to be deficient, having applied a discount for the time value of money will make the situation worse. The financial condition of the company (surplus) could be severely overstated. Presumably this concern has been at least one of the reasons over the years that the profession has chosen not to discount reserves. Discounting also requires the use of a discount rate; since the rate is not prescribed definitively in the proposal, it will vary from company to company, adding an additional element of judgment, potential manipulation and increased volatility to an already highly uncertain value.

I agree that using full value reserves is not a theoretical match to fair valued investments on the asset side of the balance sheet; however, this is not the only place in accounting guidance where

this situation exists regarding estimates. For example, we are prohibited from booking contingent revenue but we are required to book contingent liabilities in order to provide a more accurate reflection of potential estimated uses of surplus. Accounting literature defines conservatism as when faced with a choice, where there is doubt (as is the case with insurance reserves), we should choose the option least likely to overstate assets and income. In my view, discounting reserves that are already highly uncertain and very complex contradicts the tenet of conservatism and should not be pursued.

In summary, reserves are one of the most important, if not *the* most important, liabilities on an insurance company's balance sheet and they are highly scrutinized by various constituents. Under reserving was the reason for 40% of all insurance company insolvencies in the past 40 years. Under reserving can lead to downgrades by rating agencies, loss of customers and regulatory action. On the other hand, over reserving restricts the capital available for future growth, acquisition, new product development or geographic expansion. Over reserving reduces the surplus of a company making it appear less financially strong.

It is because reserves are so vital to the financial condition of the insurance industry that the process currently in place has been diligently established, approved and accepted by the actuarial profession (and others) and time-tested over the course of many years.

I strongly recommend the FASB reconsider its proposed requirements to change the method of setting as well as the requirement to discount reserves as provided in the proposed Accounting Standards Update, Insurance Contracts *(Topic 834)*. As a preparer (and user) of financial information/statements for various constituents (management, regulators, rating agencies and policyholders), I do not believe implementing this proposed change will improve the financial reporting for insurance contracts; instead, the changes suggested for the calculation of reserves with the additional requirement for discounting will come at a high cost of implementation with the possibility to mislead readers of the statements, create misplaced volatility and potentially diminish the high standards set for the financial condition of insurance companies.

Thank you for your consideration.

Sincerely,

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