



October 25, 2013

Technical Director  
File Reference No. 2013-290  
FASB  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, Insurance Contracts (Topic 834)

Dear Technical Director:

The Cincinnati Financial Corporation (“CFC” or “we”) appreciates the opportunity to comment on the Financial Accounting Standards Board Exposure Draft (“ED”) Insurance Contracts, Topic 834.

CFC is an insurance holding company that provides property and casualty (P&C) and life insurance to both individual and business customers in the United States. Our response is based on largely being a property and casualty entity.

Our financial reporting objective is to prepare financial statements in accordance with U.S. GAAP (accounting principles generally accepted in the United States of America) and provide investors with clear, easy to understand information to evaluate our results and the return on their investment. Historically, we have provided much detail and disclosure in our 10-Q and 10-K filings and earnings news releases.

While we support the efforts of the FASB to improve the financial reporting framework when warranted, we do not believe the ED would be an improvement over current U.S. GAAP or that it would present financial statements that are more reliable or more relevant to users. We do believe the ED will result in increased financial statement volatility and decreased comparability for investors. In addition, we believe the proposed insurance contract standard will be extremely difficult to implement and create additional costs to maintain the accounting and actuarial departments. A summary of our observations is provided below:

***Initial and subsequent measurement using the Premium Allocation Approach (PAA)***

Liability for incurred claims –

We disagree with the PAA proposal of claims reserve measuring using a present value, unbiased probability-weighted estimate of future net cash values method, versus today’s method of most likely outcome from a range of possible reserve estimates. This proposal replaces a time-tested actuarial methodology with a single probabilistic method not widely used by actuarial professionals. We recognize there can be differences in current actuarial judgments used by P & C entities to record reserves. The proposed method will not eliminate these differences because of various other judgments in the ED, such as onerous contracts and portfolio decisions that will only add more differences. As an example, we disagree with the proposal to accrue losses prior to a catastrophe occurrence, based on probability assumptions. This will cause unneeded volatility in earnings and comparability issues as various entities will have differing probability assumptions.

The proposed cash flow accounting model (using the mathematical mean) takes away some ability to have our opinion of “best estimate” reserving, by not having the ability to reserve outside the unbiased mean. Our interpretation of best estimate reserving, based on our reserving philosophies, can be different than other entities. This new method is untested and may put an entity’s equity at risk until the new methodology is proven to be accurate.

## Liability for remaining coverage –

We disagree with the liability for remaining coverage methodology proposal, requiring usage of the expected timing of coverage of incurred claims instead of passage of time, if there are differences in the two methods. This will cause unnecessary variations in quarterly earned premiums, total revenues and net income. This will confuse investors observing potential revenue volatility each quarter, based on coverage estimates. The method will require much more effort to calculate, with no related benefit. Comparability issues between entities will occur, as judgments and assumptions will vary. An investor will need to read disclosures by entity to compare and understand the differences in assumptions that result in varying earned premium patterns. Today, revenue changes from prior periods are largely based on sales and growth initiatives, which we disclose and discuss. Current reporting is easier for investors to understand and more useful when analyzing growth trends in our business.

In addition, both liabilities may be required to be discounted, depending on certain criteria. Discounting liability for incurred claims makes it more difficult for an investor to see the true changes in reserves. Investors want to review reserves and incurred claims excluding discounting, to understand the core insurance operations without financial market impacts. Most P&C reserves are short-duration contracts and are recorded with minimal changes after one year. To require subjective interest rate accounting on business that is largely short-term is not necessary. Discounting liability for remaining coverage (largely unearned premiums), when significant financing occurs, should not be required if coverages are one year or less. Again, short-term application should apply instead of complex accounting.

## ***Presentation and implementation***

### Presentation –

Financial statement presentation proposal changes are driven by the ED recommendations. We do not support most of the ED; therefore, we do not support the presentation changes.

Changes to the balance sheet and income statement presentations, by adding PAA and BBA (Building Block Approach) details, will be challenging for investors to understand. Currently, the core financial statements are simple and understandable with footnotes providing full disclosure. The ED proposes more complex financial statements with yet additional (and more complex) footnote disclosure. For example, premiums and losses are no longer presented on a net basis. Rather, the ED requires too much detail. Only sophisticated investors will grasp new statements. We are concerned whether average investors will invest in insurance entities because they may not understand the proposed statements. In addition, the presentation requires a large increase in disclosures. An average investor will need a deep understanding of finance to comprehend the new financial statements and related disclosures.

The proposal of interest rate changes recorded to other comprehensive income (OCI) is a good example of why this proposal seems problematic and unnecessary. In this proposal, the purpose of interest changes being recorded to OCI instead of net income is to avoid distortion to earnings. Most recent accounting proposals are drafted with changes impacting net income. The proposed financial instrument Accounting Standards Update, subtopic 825-10, for example, is removing the equities portion of changes in unrealized gains and losses from OCI to net income. Accumulated OCI (AOCI) and other comprehensive income is becoming an increasingly material financial presentation. Accounting changes not fitting net income presentation are recorded to OCI. Overall, equity and book value will be impacted by this. Therefore, we are misleading investors who do not see certain items in net income. Guidance seems to be inconsistent in determining when items should be recorded within net income and when they should be recorded to OCI. We recommend the board address whether or not comprehensive income is a performance measure and the result of that decision on whether or not the recording of items to OCI vs. net income is appropriate.

Investors and other financial statement users will have to develop new models to analyze and compare insurance entities. There will be little connection between statutory and U.S. GAAP accounting. Many investors use supplemental information such as statutory reporting, especially Schedule P, for detailed loss analysis and for comparison among entities.

### Implementation –

Implementation costs are difficult to determine, but we believe they will be much greater than most people are anticipating. Prior accounting standards updates did not result in several system changes, such as would be required with this proposal. Most insurance entities have multiple insurance company operations. We have five separate insurance companies. Implementation is much deeper than what it may appear, as the proposed accounting will need to be implemented for all five of our subsidiary insurance companies. Our three P&C premium systems, multiple actuarial systems, claims system and ERP system would be impacted. In addition, the proposal will also have a tremendous impact on numerous smaller insurance entities; companies that may not have resources for implementation.

Additional accounting and actuarial resources will be needed to initially implement and later apply the proposed accounting, more so than the adoption of any new standard in the past. Proper education and training for making judgments and accounting entries will take years of research and implementation. Internal reporting will need to be replaced and new financial metrics will need to be developed, replacing tested and well understood metrics in place today. Extensive training will be needed for department heads and non-financial associates to understand these new measurements of profitability. This proposal will therefore affect how our managers operate their departments, which should not be the outcome of any new accounting proposal.

IT resources, which are very difficult to obtain, will be needed to develop and update numerous processes and systems. Updating is much deeper than changing our financial ERP system. We have very sophisticated predictive models developed in the past few years, costing millions of dollars to develop, used for pricing most business lines. They will have to be rebuilt at a very high cost.

Once implemented, associates tasked to complete accurate financial reporting in the required deadlines will be very challenged. Time spent on the new financial reporting requirements will be much greater than today. The complexity will challenge our ability to present financial statements and disclosures both internally and externally within the regulatory time frame each quarter. The same challenges, as well as additional review caused by increased subjectivity, will apply to both Internal and external audit staffing. New policy and procedures as well as Sarbanes-Oxley compliance documentation and processes will need to be rewritten at a cost that cannot be justified.

Overall, after review of the proposal, we support the concept of two insurance contract measurements, but have concerns with many aspects of BBA and PAA. Specifically to PAA, we support renaming current guidance of short-duration contracts to PAA, but retain many components of the current guidance:

- Retain short-duration accounting definition (ASC 944), instead of coverage period of one year or less, which limits the changes.
- Retain current reserve calculations, with more robust disclosure for investors to be able to compare. Most PAA incurred claims would not require discounting under the proposed exposure draft, when effects of discounting are not material. We propose all short-duration contracts not be subject to discounting.
- Retain current earned premium accounting, using passage of time for amortization.
- Retain the current method of grouping contracts, based on an entity's manner of acquiring, servicing and measuring the profitability of its insurance contract (ASC 944). The proposed portfolio definition will be extremely costly to implement and maintain. Comparability of entities today, largely done by classification of segments such as personal lines and commercial lines, are easy for an investor to understand and compare.

We provide specific responses to the questions outlined in the attached Appendix. We appreciate the Board's attention to these comments and hope that they are helpful in illustrating the concerns we have about the proposed accounting for Insurance Contracts. We would be happy to discuss our comments in more detail with the Board or staff. Please feel free to call me at (513) 870-2638 if you have any questions regarding this comment letter.

Sincerely,



Eric N. Mathews  
Vice President and Principal Accounting Officer  
Cincinnati Financial Corporation

## Appendix

### **Scope**

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

We agree that all entities writing insurance contracts should follow insurance accounting, regardless of whether they are an insurance entity. This requirement would include applicable new disclosures. We are concerned with the effect on non-insurance entities because many of them do not have insurance accountants, actuaries or systems to collect transactions and calculations.

We disagree with the overall scope for property casualty (P&C) entities. P&C entities that mostly write short-duration contracts should be exempt from Building Block Approach (BBA) accounting. Premium Allocation Approach (PAA) should apply to short-duration contracts, using existing U.S. GAAP accounting rules.

### **Recognition**

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

We agree with the proposal. Our only concern is claims handling services, which is ambiguous but does not appear to be classified in the exposure draft (ED) as a service distinct and separated from insurance contract accounting.

### **Initial and Subsequent Measurement**

**Question 3:** Will the proposed measurement model produce relevant information that will help users of an entity's financial statements make economic decisions? If not, what changes do you recommend and why?

As a preparer, we feel the proposal will make it more difficult for investors to analyze our financial statements. The proposed financial statements are more difficult to understand than present financials. Each statement is lengthier and will have additional, required disclosures that are much more detailed and complex for a user to comprehend. Each entity will have differing assumptions using new accounting terms, i.e. portfolios, cash flow, discounting and other assumptions. Therefore, the proposal does not improve the goal to compare financial performance of insurers to other financial service entities.

**Question 4:** Which aspects of the proposed measurement model most significantly improve the information that will be used in making economic decisions and why?

We support having two methods of insurance contract accounting, PAA and BBA. We do not agree with most measurement aspects within each approach, and do not feel it helps investors make better economic decisions. Rather, we feel it will add complexity and the average investor will have more difficulty analyzing financial data than they do today.

### **Measurement Approaches**

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

We agree that entities should apply only two approaches to insurance contracts. Life and P&C insurance are fundamentally different and should have separate accounting approaches and financial reporting requirements. We do not agree with the components included in the proposal for each approach. We feel all P&C contracts should be entirely under the umbrella of the PAA approach. PAA is a very radical proposal that we feel is unnecessary, as the current method is well understood by investors and does not have extreme complexity. Additional disclosures to current U.S. GAAP accounting, required by all entities that issue insurance contracts, would greatly improve comparability and clarity of current accounting practices. PAA just adds complexity and subjectivity that will not improve investor understanding.

Current earned premium, unearned premium and loss reserves terms and accounting measurements are well understood. We feel the current recording of earned premiums and unearned premiums, using a pro-rata method, is the best approach

for comparability of revenues. Using the proposed method will create premium variations by quarter that will be very confusing to investors and create more earnings and liability for remaining coverage volatility.

The current method of recording reserves, with actuarial subjectivity using best estimates, is a clear and acceptable approach, compared to the proposed recording of reserves using unbiased mean ranges. Requiring improved disclosures of reserves, including reserve ranges by lines of business, would improve investor understanding of reserves. We currently disclose our reserve ranges in our 10-K MD&A discussion of reserves.

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

We do not agree with the PAA, using coverage period of one year or less being the trigger, to use this approach. This seems to be a rules-based approach and we prefer a principles-based approach. P&C entities with similar insurance contracts may have different application of PAA, depending on entity contract boundary judgment, or coverage period determinations, with different results that would not improve comparability. The current model works well and the ED is not an improvement.

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

We believe this second trigger is not necessary for using the PAA approach. P&C cash flows are largely predictable as most are short-duration contracts. This criteria adds additional accounting and complexity without benefit to investors. We recommend using current U.S. GAAP.

### **Portfolio and Contract Boundary**

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

We prefer current guidance, specifically ASC 944. This approach of grouping insurance policies based on our manner of acquiring, servicing and measuring the profitability of policies is not complex and is easy for investors to understand. Not using line of business or product type will create new criteria not currently in our database of information. In addition, current segment disclosures by line of business or product type are easily understood by investors.

The proposed portfolio approach is much more complex and we feel will be very challenging to manage and explain to investors. Comparability again will be an issue, as entities will have their own unique decisions on how portfolios are determined. In addition, each entity will have different approaches in rolling up these portfolios when disclosing segment results.

Overall, we feel the definition of portfolio is very judgmental and will have different interpretations among entities. Tracking many portfolios will be very time consuming. And testing for onerous portfolios each period will add to the timeline of financial reporting, reducing comparability.

**Question 9:** Do you agree with the requirements included in this proposed Update on contract boundary (that is, the requirements that establish how to identify the future cash flows that will arise as the insurer fulfills its obligations)? If not, what do you recommend and why?

We are concerned that contract boundary requirements in the ED may require usage of BBA accounting for many insurance contracts, which we feel is not appropriate for short-duration contracts. We do not feel it improves insurance accounting or comparability for investors.

## Fulfillment Cash Flows

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

We do not agree with the fulfillment cash flows being the method to determine the liability for incurred claims in financial reporting. Replacing actuarial techniques with one mean based model does not improve reserving. Discounting of reserves when required adds another layer of estimation that does not improve investor analysis. We support the present reserving practices, using many reserve projection techniques that are applicable to each entity's' business lines and risks, and have been time-tested.

We do not disagree with the inclusion of embedded options and guarantees but they usually are not applicable to P&C contracts.

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

Assumptions must be updated each period, whether it is the current reserving process or the proposed fulfillment cash flows process. However, the proposed fulfillment cash flows method would require much larger effort with no material improvement. We support current U.S. GAAP guidance, not the proposed cash flows method.

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

We do not agree with the ED proposal of measuring the liability for incurred claims using an unbiased, probability-weighted estimate of future cash flows. It greatly changes reserving methodologies. Current actuarial methodology uses many reserve projection methods. Weighting of these methods using actuarial judgments are applied to determine proper reserves. The actuarial profession is highly educated and trained in determining the most likely outcome of all known and unknown claims. There should be unique estimates based on the entities analysis of type of risks and the claims handling practices done at that entity. We disagree that there is little difference between entity-specific estimates and overall industry estimates.

Each entity has its own views and interpretations of estimates in what the ultimate claims will become. All entities are required to disclose in detail the methods used in setting reserves. Our 10-K details our reserve approach. We disclose the range of reserves for our major lines of business. We feel our disclosures are very robust.

It is unclear the impact of this proposal on statutory reserves and tax reserves. Federal taxes are based on statutory reserves. If we do not change statutory reserves, it is unknown how federal tax regulators will react to a material difference in recorded reserves. It is unknown how state insurance department regulators will react if we change statutory reserves to match U.S. GAAP reserves.

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

We do not agree with the fulfillment cash flows method to replace current U.S. GAAP. We do support any changes in cash flow estimates in net income.

## Discount Rates and Discounting

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

We do not support discounting of property casualty reserves. Property casualty insurance is largely a short-duration business. Reserves generally do not materially change year to year, except for large cat occurrences. Asset liability matching is not done, as in the life business. Determination of a proper interest rate by portfolio would be very challenging and may not improve comparability between entities, as each entity will have unique discount rate assumptions.

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

We do not support any discounting of reserves. Reserving estimations are inherently challenging to determine. Requiring discounting of reserves adds subjectivity on top of subjectivity. Discounting incurred but not reported (IBNR) reserves would be very challenging, since they are not typically set up on a policy or contract type (portfolio) basis. Additional internal reporting would need to be established.

We do not support discounting being required only for claims settled over one year. It would involve continual tracking and monitoring of paid claims. We have many package policies that combine property and casualty coverages. Claims on these types of contracts can have a wide variation of claim payment patterns and lengths. This requirement will add tremendous complexity to our current insurance accounting.

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

We agree that any discounting changes if implemented should be in OCI. However, discounting in general adds volatility to overall financial reporting. Using OCI as the location where discount rate changes would be recorded lessens the impact to the income statement. Volatility still occurs in equity and book value.

**Question 17:** Because the proposed guidance includes the approach under which changes in the insurance liability arising from changes in the discount rates should be recorded in other comprehensive income, do you think that a test should be required to trigger recognition in net income of some or all of the amounts in accumulated other comprehensive income (that is, a loss recognition test based on asset-liability mismatches)? Why or why not?

We do not support any inclusion of discounting rate impact in net income. This adds more disclosure and discussion to investors about net income volatility. Keeping all discount transactions in OCI at least limits disclosure. A test to trigger some recognition in AOCI would add complexity.

**Question 18:** Do you agree that the method for calculating the discount rates should not be prescribed? Is the proposed guidance on determining the discount rates understandable and operable? If not, what do you recommend?

We disagree with any discounting being applied to PAA insurance contracts. If discounting is required, we recommend a prescribed discount rate method, for comparability purposes and investor benefit, such as an AA corporate bond rate. An investor analyzing various insurance entities that use different discount rates will have to understand each discount rate choice to determine comparability. Two methods were discussed in the proposal, the top down and the bottom up methods. With choices, additional disclosure will be required to investors, explaining the choice of method.

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

We disagree with any discounting being applied to PAA insurance contracts. If discounting is required, we agree the discount rate determination should be at inception, when portfolios are initially recognized. It is easier to apply and will help investors compare.

**Question 20:** Do you agree that upon any change in expectations of the crediting rates used to measure the insurance contract liability for insurance contracts with discretionary participation features, the interest accretion rates should be reset in a manner that recognizes any changes in estimated interest crediting and related expected cash flows on a level-yield basis over the remaining life of the contracts? If not, what do you recommend?

No comment; not applicable to P&C insurance contracts.

#### Margin for Contracts Measured Using the Building Block Approach

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

No comment; not applicable to P&C insurance contracts.

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

No comment; not applicable to P&C insurance contracts.

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

No comment; not applicable to P&C insurance contracts.

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

No comment; not applicable to P&C insurance contracts.

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

No comment; not applicable to P&C insurance contracts.

**Question 26:** Do you agree that interest should be accreted on the margin and therefore affect insurance contract revenue? If not, why?

No comment; not applicable to P&C insurance contracts.

**Question 27:** Do you agree that if the expected cash outflows (including qualifying acquisition costs) of a portfolio of insurance contracts will exceed the expected cash inflows, an entity should recognize the remaining margin immediately in net income? Why or why not?

No comment; not applicable to P&C insurance contracts.

#### Acquisition Costs

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

We agree with the PAA proposal. It is consistent with today's guidance, after recent modification.

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

We do not agree with deferred acquisitions cost assets being netted with liabilities for remaining coverage. It reduces transparency and lessens investor understanding. A disclosure may be necessary to show this liability excluding the asset, which seems unnecessary if we can show the asset separately on the balance sheet. We prefer reporting a deferred acquisition asset and release the amortization of that asset separately, as is done today.

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

The reduction of liability for remaining coverage is based on usage of expected timing of coverage of incurred claims instead of passage of time. We do not agree with recognizing acquisitions costs in that manner. We prefer what is allowed under current U.S. GAAP.

### **Insurance Contract Revenue**

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

We feel investors prefer the current presentation of financials by showing revenues and expenses. Financial reporting of only margin changes would be unusable to investors.

Revenue disclosures are extremely important for investors to compare and understand. The concept of collection of premiums and its conversion to earned premiums in revenue presentation should be retained. We do not support the release of liability for remaining coverage based on expected timing of incurred claims. We support the current passage of time method of earning premiums.

Likewise, expense disclosures are important for investors to understand how an entity is managing their expenditures. Current financial presentations include a non-GAAP measurement using a combined ratio measurement. This is a very easy way for investors to compare and understand property casualty financial results. The GAAP-based ratio is the percentage of incurred losses and expenses per each earned premium dollar. A profit results when the combined ratio is below 100 percent and represents an entity has profitable insurance underwriting performance. This measurement will not be usable in the future because discounting reserves lowers incurred losses and the new mythology of earned premiums will not allow a combined ratio calculation that would be meaningful.

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

We agree with the PAA proposal.

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

This is not a material item for our companies. However, we do not agree this is necessary to discount and increases complexity, volatility and lessens comparability.

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

No comment; not applicable to P&C insurance contracts.

### **Participating Contracts**

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

No comment; not applicable to P&C insurance contracts.

### **Reinsurance**

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

We agree with the proposal, to be consistent with underlying contracts. However, we prefer following current U.S. GAAP.

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

We agree with the proposal, to be consistent with underlying contracts. However, we prefer following current U.S. GAAP.

### **Insurance Contracts Acquired in a Business Combination**

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

#### **Contract Modifications**

This proposal is a significant change from current U.S. GAAP, which allows an asset or liability in recording a business acquisition. We would support current U.S. GAAP accounting. However, we historically have been an infrequent acquirer of other entities, so this provision may not apply to our company.

## Contract Modifications

**Question 39:** Do you agree that for a substantial modification (a) an entity should recognize a gain or loss as the difference between the measurement of the modified contract using the current entity-specific price that the entity would hypothetically charge the policyholder for a contract equivalent to the new contract and the carrying amount of the existing contract and (b) that the carrying amount of the existing contract should be derecognized? If not, what do you recommend?

No comment.

## Presentation

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

We do not agree with the proposed financial statements. The ED proposals, such as discounting, will be more challenging for investors to interpret. We do not feel the ED is an improvement over current presentation guidance. The current presentation, with disclosures, provides useful information for investors.

## Disclosure

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

We support robust disclosures which benefit investors. This ED requires a large increase in disclosure. In addition to the new required disclosures, we are concerned that there will be an increased amount of non-GAAP disclosures for an investor to understand the more complex ED. We propose enhancing current disclosure requirements to current financial statements rather than implementing new insurance contract accounting.

## Effective Date and Transition

**Question 42:** The Board will establish the effective date of the requirements when it issues the final amendments. However, the Board is interested in determining the key drivers affecting the timing of implementation. What are those key drivers? How do those drivers affect the time it will take to implement this proposed guidance?

We encourage a rapid approach to the decision-making process of the ED. There are numerous issues to be examined under this proposal. Waiting many months for a decision will not benefit our analysis and implementation of insurance contract modifications, as multiple systems will need to be modified.

Key drivers include:

- Necessary modifications to policy, actuarial, claims and ERP systems, such as:
  - reserving processes
  - general ledger and financial close processes
- Developing discounting of short-duration contracts.
- Acquiring appropriate IT resources.
- Additional staffing and education for accountants, actuaries and managers.
- Rewriting policy and procedures.

**Question 43:** Do you think the effective date should be the same for both public and nonpublic entities? Do you think the effective date should be the same for regulated insurance entities and other entities that issue insurance contracts within the scope of this proposed guidance? Why or why not?

We agree the proposal should have the same effective date for all entities impacted. Investors will not benefit from a staggered approach. However, consideration should be given for the various types of entities involved before a date is selected.

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

Transition will be incredibly challenging. We agree retrospective application is the only practical choice, as investors need comparability in financials. We will have to use significant judgment to determine margins in prior years. However, providing only 3-5 years of information may not be enough for proper analysis, since there are many new financial measurements. Using estimated margin and discount rates where observable data is not available, will at best give similar results to current year. We believe looking back for a retrospective application will be inoperable in a majority of entities.

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

No comment.

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

We believe investors will lose understandability and faith within the insurance industry and may move investment allocations to other sectors.

### Costs and Complexities

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

One-time costs include:

- Development of a new reserving system
- Evaluation and modifications to current ERP systems. We will need to determine if our current ERP system can be modified or need replacement, which will be much more costly.
- Evaluation and modification of our claims system and numerous policy systems. Our sophisticated predictive modeling tools will need to be rewritten.
- System modifications to capture and calculate information to report reconciliations and other disclosure requirements
- Discounting would require new financial tracking, reporting and calculation systems. Discounting IBNR would have to be developed. IBNR would need to be much more granular to have a proper discount rate for different types of IBNR contracts.
- XBRL and Sarbanes-Oxley controls will need major modifications
- Retooling all internal management reporting to track the new components of financial results will be immense. Retraining our associates to understand new financial measurements will be a large effort. We will need to develop new internal metrics for decision making and compensation evaluations. Educating associates so they are able to analyze and develop their own reports as it is today, will take a lot of time and effort. More complex and expanded disclosures will require more reports and more analysis. This will increase pressure on our financial statement close calendar.

Ongoing costs include:

- Additional accountant and actuarial staffing
- Additional reporting for disclosures
- Additional reconciliations

**Question 48:** Describe the nature of the incremental costs of auditing the financial reporting requirements included in this proposed Update, distinguishing between one-time and ongoing costs. Explain which aspects of the model in this proposed Update are driving those costs.

No comment

