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The Reinsurance Association of America (RAA) appreciates the opportunity to comment on the Financial Accounting Standards Board (FASB) June 2013 exposure Draft (ED): Insurance Contracts (Topic 834).

The RAA is a national trade association representing reinsurance companies doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross border basis.

The RAA and its members have closely followed the developments toward a global insurance accounting standard since before 1997. We support the goals of the FASB and IASB to create a single, global accounting standard for accounting for insurance contracts. As reinsurers, we are acutely aware of the global nature of the capital and insurance markets. Accordingly, we strongly favor the development of a common financial reporting standard for insurance that promotes consistent, reliable and comparable information that is decision useful. We praise the two board's efforts thus far in attempting this difficult task.

While the RAA supports the FASB's objectives and applauds its efforts, we have many concerns with the proposals in the proposed ED, and in particular the failure of the FASB and IASB to reach convergence in their respective proposals. Due to the nature of our members, which all operate globally, there are several elements and questions in the exposure draft for which we could not reach consensus. A significant portion of members are U.S. or Bermuda based U.S. GAAP reporting (re)insurers, while another portion are European based (re)insurers that currently prepare IFRS financial statements. The U.S. centric RAA members ultimately cannot support the proposed model because convergence is not achieved and because the added complexity, subjectivity and significant implementation costs associated with the proposal do not justify a change from existing U.S. GAAP for short-duration, non-life insurance contracts. Our European based members are willing to support the proposed model if certain critical elements are improved. Convergence is a common concern to all of our members and RAA members would be more supportive of the ED if it truly met the two boards' objectives in this regard.

While a portion of RAA members write life insurance and reinsurance, the RAA is primarily a property and casualty oriented trade association. As a result and unless otherwise noted, the comments throughout the remainder of this letter are intended to be solely directed to the application of the ED to non-life, specifically property and casualty, (re)insurance contracts.

## Summary

As described in the following pages, a large proportion of RAA members do not believe that the FASB's proposed accounting and measurement model contained in the ED would result in more relevant, reliable, comparable and decision useful information for users of insurance and reinsurance financial statements. These members believe that in this regard, the proposal fails to meet the main objective described on page 7 of the ED. Instead, and in particular because convergence will not be achieved, the FASB should only make targeted changes to existing U.S. GAAP for non-life (re)insurance contracts for the few areas, if any, where existing U.S. GAAP could be improved. These members believe that current U.S. GAAP for non-life contracts is widely used and understood and thus provides consistent, comparable and decision useful information for users. Some members that hold these views have suggested that because IFRS does not currently have a complete standard for insurance contracts that the FASB should observe the final development and implementation of the IFRS standard before embarking on any wholesale amendment of existing U.S. GAAP for non-life (re)insurance contracts.

Other members, primarily those headquartered in Europe, are more supportive of the ED subject to certain critical changes. These members typically file consolidated financial statements that encompass both life and non-life (re)insurance operations for which the building block approach (BBA) is a necessary element. These reinsurers in particular believe that a single converged standard that addresses both life and non-life contracts using a principles-based approach is fundamentally necessary.

Following is a brief summary of some of our most important observations and comments, most of which are described in more detail in our responses to the specific questions. Unless otherwise noted, these concerns are a consensus view among RAA members.

1. The proposed model as applied to (re)insurance contracts for infrequent but severe events does not provide decision useful information to users of financial statements. The onerous contracts test is an expected loss model. As a result, losses associated with infrequent but severe events such as a hurricane approaching landfall prior to the reporting date, would trigger the onerous contracts test. In these situations, potential losses must be estimated and recorded using probability weighted cash flows (PWCF) before the underlying event giving rise to the loss occurs. This will likely result in substantial over or underestimation of the losses, which will then be reversed in the following reporting period. The judgment and subjectivity surrounding the measurement

of these losses will impair consistency and comparability and will provide less decision useful information to users of (re)insurers' financial statements.

2. The eligibility criteria for the premium allocation approach (PAA) are unclear and too narrow. In the course of our evaluation of the PAA criteria, it became clear that there is substantial diversity in interpreting the second criteria "variability in the expected net cash flows during the period before a claim is incurred." The result will likely be significant diversity in classification of contracts. Moreover, we believe that the criteria inappropriately excludes multi-year and risks attaching contracts that should be measured using the PAA. The language of the final standard should make clear that the measurement model will not change solely because the coverage period extends beyond one year.
3. We disagree with the FASB requirement that all contracts eligible for the PAA must be measured using that approach. Many (re)insurers write life and non-life contracts that will be measured using the BBA approach. These (re)insurers may prefer to use the BBA approach for all insurance contracts rather than maintain two distinct measurement approaches and the related systems, processes and controls to track this information. Similarly, these companies believe that separate reporting of both measurement methods in the financial statements is burdensome, will likely be confusing to users and thus they prefer the IASB's optional approach to selecting the measurement model.
4. The definition of portfolio lacks clarity and would result in an unmanageable number of portfolios that will be required to be measured separately. The ED simply provides too many criteria for segregating separate portfolios and ignores how management views their business. Since the portfolio definition drives so much of the proposed guidance, including the OCI adjustment for changes in discount rates by portfolio cohort, the proposed definitions will be very costly to implement with little corresponding benefit.
5. Separating the investment component and accounting for it on the balance sheet as the estimated returnable amount fails to recognize the true nature of these contract provisions and will be very costly to implement, particularly for reinsurers. Experience rated features are a pricing mechanism common to most reinsurance contracts. They are customized contract provisions that cannot be estimated on a portfolio basis and will have to be tracked separately for each reinsurance contract. Experience rated features are dependent on underwriting results and should be reflected in underwriting activity in the financial statements. Separate reporting of certain insurance contract provisions should only be required when the elements of the contract are distinct and clearly separable.
6. Netting acquisition costs with the liability for remaining coverage reduces transparency. We believe a gross presentation allows for greater transparency of the underlying cash flows resulting from premiums and acquisition expenses.
7. Similarly, ceding commissions should not be netted against ceded premiums and the liability for remaining coverage. We believe that a gross presentation allows for greater transparency of the underlying cash flows between the cedent and its

reinsurers. The proposed approach would yield drastically different premium amounts and thus different operating ratios for otherwise identical cedents that have different reinsurance utilization rates. The proposed ED approach also creates additional complexity because the amounts netted on the balance sheet must be reported separately in the statement of comprehensive income and in the disclosures.

8. The presentation format is confusing and will result in less clarity of operating performance. While the majority of RAA members prefer the current presentation format versus the margin approach proposed in the prior FASB Discussion Paper, the presentation of various amounts separately under the BBA and PAA measurement approaches clutters the financial statements and will likely be confusing to users. Some RAA members prefer the margin approach for the same reason.
9. The recommended disclosures are excessive and should be reduced to elements that are more objective and auditable. The very detailed and often subjective elements will significantly impact quarterly closing procedures and will require capturing much more information in (re)insurers' systems and processes. The proposal would lead to more costly auditing procedures of information currently reported in (re)insurers MD&A.
10. The costs to implement the proposed ED will be very significant and permanent.

**Responses to Specific Questions**

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?*

Yes. In general, we agree that the proposed guidance should apply to all insurance contracts regardless of the issuer. We agree with the objective of the ED to shift U.S. GAAP from accounting guidance for insurers to accounting guidance for insurance contracts. However, we believe it is important to continue to allow for the use of the fair value option under ASC Topic 825 *Financial Instruments* for (re)insurance contracts.

Recognition

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

Yes, in part. We generally agree with the definition of distinct investment components and the requirement to separate these components. However, the requirement to separate performance obligations to provide goods and services provided in connection with insurance contracts is unduly onerous. The cost of pricing and splitting certain ancillary services, such as claims handling from insurance coverage seems unduly high compared to financial impacts, and therefore has limited decision-usefulness. In our view, the guidance should specifically identify which features are not considered part of an insurance contract, and the results should be conclusive. No further disaggregation of an insurance contract into additional components should be required for measurement or presentation as we do not think this provides decision-useful information.

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?*

The RAA was unable to reach consensus on this question. Members with a U.S. GAAP perspective or that are primarily engaged in writing non-life (re)insurance contracts believe that the existing U.S. GAAP model is time-tested and proven to provide relevant, reliable, comparable and decision useful information to financial statement users. They believe that the guidance in the proposed ED, particularly the use of the BBA approach, including unbiased PWCF and discounting to measure insurance reserves will add significant complexity, costs and subjectivity that will not result in better, more decision useful financial statement information for users than current U.S. GAAP. The problems in the measurement model are compounded by subjectivity in determining portfolio levels, the lack of clarity in determining which contracts are eligible for the PAA, less transparency by netting amounts in presentation such as commissions and ceding commissions, and the recommended presentation in the statement of comprehensive income and balance sheet.

Among the most significant issues of concern is applying the expected loss model to infrequent but severe insured events. The proposed ED requires that losses associated with infrequent but severe events, such as a hurricane approaching landfall prior to the reporting date, would trigger the onerous contracts test. In these situations, potential losses must be estimated and recorded using PWCF before the underlying event giving rise to the loss occurs. This will likely result in substantial over or underestimation of the losses, which will then be reversed in the following reporting period. The judgment and subjectivity surrounding measurement of these losses will impair consistency and comparability and will provide less decision useful information to users of (re)insurers' financial statements. We believe that an incurred loss model rather than an expected loss model is more appropriate for non-life (re)insurance contracts, particularly for coverage for infrequent but severe events where more accurate loss information will be known soon after the event takes place.

RAA members are divided on whether non-life (re)insurance obligations should be recorded on a nominal or discounted basis. Those members who support the recognition of the time value of money in the valuation methodology view this as the most important element that will improve the relevance to users of the proposed model contained in the ED. These members' view is that management considers the time value of money in its performance measurement for pricing and other decisions and it should be reflected in the new global accounting standard. Other RAA members view the proposed use of discounting and other inter-related elements of the ED as substantially increasing the costs and complexity of the proposed model, while providing less transparency, comparability and utility to users, who will still require loss information on a nominal basis. These members also view the proposed discounting model essentially as an aggressive acceleration of the recognition of future investment income.

Other concerns about the relevance to users of the proposed measurement model are summarized in the first section of this comment letter.

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

The RAA was unable to reach consensus on this question. Some members believe the proposed ED would be an improvement because it incorporates the time value of money. In addition, because the proposal applies to contracts and not entities, it may provide more decision useful information for financial reporting by banks and other entities that issue insurance contracts (within scope) to the extent there is diversity in practice in accounting for these contracts. The proposed ED will bring similar accounting for similar contracts as long as they are within scope.

Other members believe that given recent improvements in the U.S. GAAP treatment of acquisition costs and the SEC's improved disclosures for loss reserves, that current U.S. GAAP for non-life (re)insurers is very good without this major change. These members believe that the proposed measurement model, while intellectually appealing in concept, will in practice provide less transparent, comparable and decision useful information to users than current U.S. GAAP for non-life contracts. These members comment that the diversity in practice that the ED cites as justification for the proposed changes does not exist with respect to current U.S. GAAP for non-life contracts.

Measurement Approaches

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

Yes, but we do not believe that the eligibility criteria for the PAA and BBA properly differentiates contracts with dissimilar characteristics. In the course of our evaluation of the PAA criteria, including our discussions with several other organizations evaluating the ED, it became obvious that there is substantial diversity in interpreting the second criteria "variability in the expected net cash flows during the period before a claim is incurred." The result will likely be substantial diversity in classification of contracts. Moreover, we believe the criteria inappropriately excludes multi-year and risks attaching contracts that many of our members believe should be measured using the PAA. The language of the final standard should make clear that the measurement model will not change solely because the coverage period extends beyond one year.

Many RAA members believe that all non-life contracts should be measured under the PAA approach and that the current U.S. GAAP guidance for differentiating between short and long duration insurance contracts is well understood and effective. These members vastly prefer the incurred loss model used in the PAA approach over the expected loss model in the BBA approach for non-life contracts.

Other members, primarily those headquartered in Europe, typically file consolidated financial statements that encompass both life and non-life (re)insurance operations for which the BBA approach is a necessary element. These (re)insurers would prefer the option to use the BBA approach for all insurance contracts rather than maintain two distinct measurement approaches and the related systems, processes and controls to track this information. They view the two measurement models as different methods to reach the same result and therefore support the IASB's position that the use of either model is optional.

***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?*

No. See response to question No. 5 above.

***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?*

No. We believe this guidance is unclear and is subject to a substantial range of interpretation. We also believe that there should be an option to apply the BBA approach to contracts that otherwise meet the PAA criteria. As stated above, we believe that (re)insurers should have the option of applying the PAA approach to all short duration contracts, as currently defined under U.S. GAAP, or to apply the BBA measurement approach to all contracts.

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 are in general agreement with the definition of portfolio in the glossary and in paragraph 834-10-55-46 of the ED, but are concerned that follow-on guidance creates additional confusion in the definition that would ultimately result in an unmanageable number of portfolios that will be required to be measured separately. The ED provides too many criteria for segregating separate portfolios (e.g. paragraph 834-10-55-48) including by type of coverage, product line, type of policyholder and by geographical location. These criteria ignore how management views their business. As a single example, (re)insurers often manage natural catastrophe exposure across many geographical areas together.

The definition of a portfolio is an essential element of the proposed standard as it is a determining factor in several other elements of the ED including: 1) the measurement approach; 2) qualifying acquisition costs and other cash outflows; 3) discounting requirements (whether immaterial or less than 12 months); 4) calculation of the OCI adjustment for changes in discount rates; 5) margin release and 6) presentation and disclosure. Since the portfolio definition drives so much of the proposed guidance, unless simplified the proposed definition and additional guidance will be very costly to implement with little corresponding benefit. We recommend that the FASB adopt a definition of portfolio more consistent with current U.S. GAAP, under which contracts are grouped consistent with the (re)insurer’s manner of acquiring, servicing and measuring the profitability of its contracts.

***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?*

Yes. We think the definition is much improved over the prior FASB discussion paper guidance that would in many instances have forced recognition of (re)insurance contracts before the effective date of coverage.

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?*

Yes, for the most part. We do not believe that most of the types of cash flows mentioned in this question are applicable to non-life contracts. However, as stated in our answer to Question No. 2, while we generally agree with the definition of distinct investment components and the requirement to separate these components from the insurance valuation model, the requirement to separate performance obligations to provide goods and services provided in connection with insurance contracts is unduly onerous. The cost of pricing and splitting certain ancillary services, such as claims handling from insurance coverage seems unnecessarily high compared to financial impacts, and therefore has limited decision-usefulness. In our view, the guidance should specifically identify which features are not considered part of an insurance contract, and the results should be conclusive. No further disaggregation of an insurance contract into additional components should be required for measurement or presentation as we do not think this provides decision-useful information.

Some members, primarily those headquartered in Europe, would also prefer to include other costs, such as acquisition costs and premium taxes in the cash flows included in the fulfillment cash flows under the BBA approach. These members prefer the IASB approach in which more costs are included in the measurement cash flows.

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

Yes. Updating assumptions is a necessary component of any comprehensive accounting model. We expect that because there will be more assumptions involved under the BBA approach than in current U.S. GAAP that this requirement may impact the timing of the quarterly close for (re)insurers using that measurement approach.

***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?*

The RAA was unable to reach consensus on this question. While this may not have been the FASB's intention, many of our members view the requirement to calculate unbiased PWCF estimates to measure the liability for incurred claims under the PAA approach to be a major departure from current practice. Actuaries from these member companies do not believe that the language of the ED is consistent with current practice under Actuarial Standard of Practice (ASOP) 43 because it appears to require the exclusive use of stochastic modeling to arrive at a statistical mean rather than the actuarial central estimate which is a more deterministic model and one that requires significant professional judgment. Members who share these views are concerned that while PWCF estimates are commonly used in dynamic financial analysis and enterprise risk management functions, they will both result in an undesirable diversity of practice among (re)insurers and will reduce the transparency of the loss reserving process. Finally, such a major change in reserve estimation processes will require significant actuarial resources, systems changes and will involve significant additional internal and external audit costs.

Other members are of the impression that the FASB did not intend to propose a method that would change current actuarial practices for measuring the liability for incurred claims. They do not believe that using PWCF estimates is a significant change from current actuarial practice and recognize that the same estimation techniques are used in reinsurance pricing, reinsurance risk transfer analysis (under current U.S. GAAP) and in enterprise risk management processes.

***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?*

The RAA was unable to reach consensus on this question. Several members believe that as under current U.S. GAAP, changes in the estimates of the liability for incurred claims, however measured, should be reflected in current income. Other members, primarily those headquartered in Europe, would prefer that changes in estimated cash flows first impact the margin before being reflected in net income. These members prefer the IASB's approach for recognizing changes in estimates of cash flows.

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?*

Yes. The discount rate for non participating contracts should reflect the characteristics of the liability. In general, non-life insurers view their underwriting activity separately from their investment activity and thus don't close match asset and liabilities in the manner many life (re)insurers do. As a result, we do not believe that the asset return rate should influence liability measurement.

***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?*

The RAA was unable to reach consensus on this question. A significant portion of RAA members believe that discounting of insurance reserves is a necessary element of any converged global accounting standard. While supportive of recognizing the time value of money in the new standard, several of these members remain concerned that the totality of the proposed model remains excessively complex, costly to implement and that due to the subjectivity on the implicit inputs, judgments and assumptions, it will not provide comparable and more decision useful information than current U.S. GAAP.

Other RAA members believe that discounting the liability for incurred claims on non-life contracts is not desired by the users of financial statements and simply will not be an improvement over current U.S. GAAP for non-life insurance contracts. They also cite as reasons for opposing discounting the subjectivity of the process as well as the permanent costs to implement such a standard.

Should the FASB decide to require discounting, our members do not support the practical expedient that discounting would not be required for portfolios when the incurred claims are expected to be paid within one year. We would prefer a principles based rule based on materiality alone since paid within one year may be too low a threshold in some cases and too high a threshold in a high interest rate environment. As an example of the former, many short duration (re)insurance contracts, including property catastrophe losses and traditional excess of loss business (after retention) are not paid within a year of the event but may be regularly paid within 14 to 18 months, for example.

***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.*

The RAA was unable to reach consensus on this question. Our members appreciate the change from the prior FASB Discussion Paper to recognize the effect of discount rate changes in other comprehensive income (OCI). This would reduce the volatility in net income arising from this source. However, upon reflection and in view of the totality of the model, including the granular definition of portfolio, many members are concerned that such an approach will be excessively complex and costly to implement. These members believe that in order to calculate the OCI adjustment the yield curves at inception for each portfolio and each quarterly portfolio cohort will have to be archived for later comparison to current yield curves on similar cash flow patterns at each reporting date. They view this accounting process as very complex and costly and one that will require significant systems changes and new internal control procedures that are likely to outweigh the benefits of such treatment.

For some members, the above analysis is further evidence that the introduction of discounting for short duration contracts is ultimately undesirable because of the resulting complexity necessary in other parts of the accounting model. Several of these members would prefer that if discounting is required, that the change in both PWCF assumptions and the change in discount rates be reflected in underwriting income. This issue raises a separate concern for RAA members holding this view. The proposed ED creates a mismatch between underwriting results and the accretion of the discount on loss reserves. The initial discount of PWCF affects underwriting results but the subsequent unwinding of the discount is recorded as interest expense. These members prefer that if losses are discounted in the final standard that all of the effects of discounting flow through interest expense.

Other RAA members currently account for their investments at fair value with all realized and unrealized gains and losses reflected in net income. The proposed OCI treatment would create a new accounting mismatch for these entities. As a result of all of these considerations, a majority of members believe that the recognition of the effects of discount rate changes in OCI should be an accounting policy election rather than a specific requirement.

***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?*

No. Adding a loss recognition test would further complicate the accounting, will result in reduced comparability and will likely only be relevant to life insurers, which due to their different product lines, must more carefully match assets and liabilities.

***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?*

Yes. We agree that the method for calculation the discount rates should not be prescribed. However, sufficient guidance for selecting this rate must be provided in the final guidance so that rates selected are reasonably consistent to provide users with comparable information on which to make economic decisions.

***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?*

Yes. However as noted above, the selection, archiving and tracking these rates against current rates makes the OCI adjustment complex and burdensome. The only alternative that we can imagine is basing these rates on incurred loss dates. In our view this approach would be substantially less desirable for reinsurers as it would involve even more discount rates based on portfolio (actually claim date) cohorts.

***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. We view this as a life only question.

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?*

Yes. We agree with the fundamental principle that no gain should be recognized at contract inception because the provision of insurance services has not occurred. The margin should be recognized over the coverage period as these services are provided.

***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.*

The RAA was unable to reach consensus on this question. A substantial portion of RAA members support a single margin approach. They believe that calculating a separate risk adjustment would add further complexity and would result in further inconsistency in the application of the model. These members prefer the single margin approach under which changes in estimates and assumptions flow to net income directly rather than as and adjustment to the contractual service margin (CSM).

Other members, primarily those headquartered in Europe, strongly support the IASB's recommended approach utilizing a separate risk adjustment and CSM. These members believe that a separate risk adjustment is necessary to express quantitatively the uncertainty in the liability as an integral part of the measurement of that liability. They believe that a separate and explicit risk margin will provide a clearer picture of the profit drivers and earnings streams of the portfolio of 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?*

The RAA was unable to reach consensus on this question. As noted in our response to question 22 above, this question is inapplicable for a significant proportion of members who support a single margin approach. For those who favor a dual margin approach, they believe that the FASB and IASB should not specify the approach for calculating the risk adjustment. Instead, the method used to measure this risk should be the method that the (re)insurer believes best quantifies the uncertainty in the insurance liabilities.

***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?*

Yes. If at the inception of a portfolio of contracts the present value of probability weighted cash outflows exceeds inflows, then a loss should be recorded. The rationale is similar to the rationale behind the premium deficiency reserve under current U.S. GAAP and proposed onerous contract test in the ED. The BBA is an expected loss model. Therefore in situations in which the services have not yet been provided, if there is an expectation of incurring a loss upon fulfilling the contract, it should be recognized immediately.

***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?*

Yes. We agree with the ED treatment for margin release under the BBA and PAA approaches. Under the BBA approach, margin is intended to be released over the coverage and settlement periods. Under the PAA approach, margin is recognized over the coverage period as this is the period over which the insurer is released from risk.

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

Yes, we agree that interest should be accreted on the margin for the BBA approach. We agree that it is necessary to accrete the margin as it represents the unwinding of the discount from the inception of the contract until claims are paid, that is through the end of settlement period.

***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?*

Yes. Deferred revenue should be written off if the expectation is that the portfolio will make a loss.

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?*

The RAA was unable to reach consensus on this question. Several members are supportive of limiting acquisition costs to only those directly related to the (re)insurer's successful selling efforts. This treatment was established in ASU 2010-26. However some members who were supportive of the conclusions of ASU 2010-26 because of certain grandfathering provisions are concerned about this proposed guidance. They note that certain direct costs for successful efforts, such as ceding commissions, are easy to measure and track for reinsurers. However, because reinsurance contracts are bespoke, acquisition costs vary significantly from contract to contract and it will be necessary to track time and costs at the individual contract level. Identifying and separately measuring the direct costs for successful and unsuccessful efforts will be difficult and will involve substantial increase in accounting costs and administrative expenses. As a result, these members support the IASB view that direct costs for both successful and unsuccessful efforts should be included in the margin.

***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?*

No. Netting acquisition costs with the liability for remaining coverage reduces transparency. The netting approach also increases complexity of the model because the two components that are netted on the balance sheet need to be tracked separately for presentation in the income statement and in the disclosures. We believe a gross presentation allows for greater transparency of the underlying cash flows resulting from premiums and acquisition expenses.

RAA members also believe that cedents' accounting for ceding commissions should similarly not be netted against the liability for remaining coverage and against direct premiums in the income statement. To do so creates comparability issues. Identical cedents that have different reinsurance utilization rates will report significantly different premium amounts and operating ratios. Moreover, netting obscures the relationship between direct premiums, ceded premiums and net premiums on ceding insurers' performance statement. As a result, we strongly believe that this treatment is less transparent and would impair comparability among (re)insurers.

***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 RAA was unable to reach consensus on this question. Several RAA members agree with this pattern of recognition, which for the PAA approach would be recognized over the coverage period. They believe that this approach is consistent with current U.S. GAAP. Other members, primarily those headquartered in Europe, agree with the IASB and believe that under the BBA approach, other costs, including acquisition costs should be reflected in the measurement of the fulfillment cash flows rather than in the margin.

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?*

The RAA was unable to reach consensus on this question. Our members with a non-life perspective strongly favor the proposed presentation model over the margin approach. While these members believe the proposal provides more decision useful information about insurance contract revenues and expenses than the margin approach, they question the utility of separately presenting the amounts in the performance statement under the separate BBA and PAA measurement approaches (e.g. insurance contract revenue, ceded reinsurance consideration, claim benefits incurred, reinsurance recovered on incurred losses) and suggest that they be combined. Concerns about the specific format for reporting are further addressed in our answer to question No. 40.

Other RAA members, primarily those that write significant life (re)insurance business, prefer the margin approach because it is a simpler presentation. These members also question the utility of separately presenting the amounts in the performance statement under the separate BBA and PAA measurement approaches. They believe that the current proposal clutters the face of the performance statement and this information would better be disclosed in the footnotes.

***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.*

No. This issue is one of the RAA's most significant concerns with the exposure draft. We believe that separating the investment component and accounting for it on the balance sheet as the estimated returnable amount fails to recognize the true nature of these contract provisions. Experience rated features are dependent on underwriting results and should be reflected in underwriting activity in the financial statements. These provisions do not represent a loan or financing mechanism and they do not obscure important information in the performance statement. Rather, they help align the economic interests and perception of risks between the buyer and seller of coverage.

Separating the reporting of contracts containing these features will be very costly to implement, particularly for reinsurers because experience based contract provisions are a pricing mechanism common to most reinsurance contracts. Moreover, these loss sensitive features are customized and unique contract provisions that cannot be estimated on a portfolio basis and therefore will have to be tracked separately for each reinsurance contract.

As a result, major systems changes and related internal control procedures will need to be devised to separately track the portion of the cash premium received, cash claims paid and "expected loss" estimates that relate to the estimated returnable amount for each individual reinsurance contract. This will be extremely costly and the benefits are questionable at best. Consider the example of a major catastrophic insured event after which analysts, regulators and other financial statement users need quick information about the size of the loss. Given that so many reinsurance contract provisions have features that would have caused a major portion of premium to be "hung up" on the balance sheet, the corresponding claims expenses will also have to be calculated and subtracted from the balance sheet liability in order to measure the catastrophic loss expense incurred. Tracking and allocating these amounts to individual contracts will take time, delaying decision useful information. Furthermore, the financial result is likely to be counterintuitive, that is a very small loss recorded for a major event for which the (re)insurer has substantial cash outflows.

We strongly urge the FASB to require separate reporting of certain insurance contract provisions only when these elements of the contract are distinct, clearly separable and plainly relate to financing activities.

***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?*

RAA members cannot think of an example of PAA contracts that have a significant financing element and do not think this should be applicable to contracts measured under the PAA approach. Since most PAA contracts are for a single year, it is hard to imagine what provisions would constitute a significant financing component. Our members believe that this proposal is likely to add significant complexity to the model. However in the unlikely event that the financing component is significant and the interest accretion is material it should be recognized as a separate component of revenue.

The practical expedient is a good idea in principle, but one year or less may be too short an interval. Many reinsurance contracts cover periods of more than one year and thus interest accretion on these balances will add significant complexity to the model and additional accounting costs. Similar to our answer to question No. 15, we would prefer a principles-based rule based on materiality.

***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. We view this as a life only question.

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 allow 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. We view this as a life only question.

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?*

No, not entirely. We understand and support the rationale for this aspect of the ED that asserts that the cedent should not recognize a gain at the inception of entering into a reinsurance contract because at that moment the reinsurer has not provided services to the cedent. Nevertheless some members believe that this idea, when applied to the margin on the reinsurance asset, provides an accounting result that is not consistent with the economics of the transaction for proportional reinsurance which varies directly with the experience on the underlying direct contracts. The contractual service margin for proportional reinsurance contracts held need to be determined in such a manner that the reinsurance asset reflects the effects generated by the release from risk provided under a reinsurance contract. As a result, these members believe that with respect to an expected loss model, there should in certain instances be a difference between the measurement of the margin for insurance liabilities and the measurement of the margin for the reinsurance asset.

While all RAA members agree that the reinsurance asset for reinsurance transactions on an aggregate basis (excess of loss contracts) should be measured as outlined in this question, some members also assert that the measurement of the reinsurance asset for contracts where the risk transfer is based on the individual underlying contracts (proportional contracts) should not be measured in this manner. In instances where the reinsurance pricing for proportional business is more favorable than the original pricing by the cedent on the underlying business, the cedent has realized an economic gain that should be reflected in the financial statements at the inception of the contract. At this point, the cedent has no additional insurance exposure on the portion of business ceded and should earn its margin. The remaining risk to the cedent is solely credit or collection risk that the reinsurer will not perform under the contract. This risk is measured separately from the insurance model and should thus not prevent the cedent from recognizing the gain or its remaining margin on the business ceded.

***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?*

No, not entirely. In general, the RAA agrees that the cedent should use the same assumptions and methods for measuring the ceded fulfillment cash flows as is used in measuring the fulfillment cash flows of the underlying business. However as stated in our response to Question No. 36, some RAA members also believe there should be an exception where the reinsurance pricing for proportional business is more favorable than the original pricing by the cedent on the underlying business. In these situations, the cedent should adjust the margin to recognize that it has no remaining insurance risk on the portion of the underlying insurance ceded to the reinsurer.

In addition and pending the final criteria for contract eligible for the PAA approach, we request that the FASB consider extending this concept to the reinsurer's eligibility to use the PAA approach. For example, a one year quota share of underlying homeowners insurance contracts would likely qualify for the PAA approach for the cedent even if the quota share is on a risks attaching basis. However, the assuming reinsurer would not likely qualify for the PAA approach for this contract as it would be considered to have a coverage period in excess of a year and would likely fail the lack of variability in expected value of net cash flows before claim is incurred test. This would result in very different accounting for the cedent and reinsurer for the same contract. We think the reinsurer should also be able to look to the underlying insurance contracts as well as to the reinsurance contract itself to determine the appropriate accounting model to be used.

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?*

No. We prefer the current U.S. GAAP treatment of treating the excess amount paid over the value of the assets and liabilities in a business combination should be recorded as goodwill.

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?*

Yes. We agree with the principle that for a substantial modification of an existing insurance contract the carrying amount for the initial contract should be derecognized and a new measurement of the modified contract be performed. We note however that this guidance appears to conflict with other parts of the model in which the cash flows are measured on a portfolio basis. That is the measurement is typically performed on a portfolio basis, but if there is a contract modification, the individual modified contracts will have to be separately measured, derecognized and removed from the portfolio, followed by the modified contracts separately measured and recognized and added to the portfolio.

Presentation

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

Yes, with modifications. Please also refer to our answer to question No. 31. With regard to the performance statement, many RAA members prefer the proposed approach in the ED over the margin approach suggested in the 2010 discussion paper. They believe that the proposed presentation is more relevant and decision useful for non-life contracts than the margin approach. Some members that expect to issue financial statements that include substantial life business prefer the margin approach, but share concerns of other members that prefer the presentation proposed in the ED as described below.

RAA members question the utility of separately presenting the amounts in the performance statement under the separate BBA and PAA measurement approaches (e.g. insurance contract revenue, ceded reinsurance consideration, claim benefits incurred, reinsurance recovered on incurred losses) and suggest that they be combined. This is a particular concern for members who expect that they will have a substantial number of portfolios measured under both measurement approaches. Our members believe that the proposal would clutter the face of the performance statement and this information would better be disclosed in the footnotes. Because other parts of the proposal substantially change the elements of revenue and claims expenses, the underwriting margin will be less meaningful than under current U.S. GAAP. These other elements are discussed in our answers to other questions and include among other elements, excluding the estimated returnable amount from premiums and claims, netting ceding commissions against ceded premiums, netting acquisition costs and the significant complexity and subjectivity inherent in the proposed measurement model.

With regard to the balance sheet, we agree that the liability for remaining coverage should be presented separately from the liability for incurred claims. These obligations are qualitatively different and should be separately presented consistent with current U.S. GAAP. We also agree that the margin under the BBA approach should be presented separately. Similarly, we question the utility of separately presenting the amounts in the balance sheet under the separate BBA and PAA measurement approaches (e.g. premiums receivable, insurance contract asset, reinsurance contract asset, and insurance reserves - excluding the liability for remaining coverage) and suggest that they be combined. The proposal would clutter the face of the balance sheet and this information would better be disclosed in the footnotes.

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?*

No. The disclosure requirements are too voluminous and will be very costly to implement. In particular the disclosures surrounding the information about significant inputs, judgments and assumptions (IJA), while necessary to an extent, are too granular particularly with respect to disclosing changes in IJA and the sensitivity of insurance balances to IJA. The insurance risk disclosures are also too voluminous and should be reduced to essential items required by investors and other users of the financial statements.

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?*

The proposed accounting model in the ED is entirely new and will require significant changes in accounting practices and internal controls by (re)insurers as well as changes in internal and external audit procedures. The key drivers affecting the time to implement the proposed standard relate to the cost and time required to implement the revolutionary changes proposed in ED, which are very significant compared to current U.S. GAAP for non-life insurance contracts.
Preparing to implement the proposed standard will require changes in:

- Actuarial and reserving methods and perhaps professional standards;
- New systems and controls to apply the measurement model;
- New systems and controls to manage and maintain what are likely to be separate records for hundreds of portfolios and portfolio cohorts, particularly for determining the OCI adjustment for changes in discount rates;
- Implementation of SOX 404 processes for SOX compliant entities; and
- Obtaining sufficient qualified accounting and actuarial resources to implement the proposal and to report timely at each quarter.

***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?*

Yes.

***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?*

Yes. However, this appears to be a more significant issue for life insurers and reinsurers.

***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. This approach is not likely to be operable as the information required to measure these amounts may no longer be available or at least not easily obtainable from legacy systems. As noted above, goodwill treatment is preferable.

***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?*

Yes. However, this appears to be a more significant issue for life insurers and reinsurers.

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.*

The exposure draft represents a significant change versus current practice and as described in our response to Question No. 42, will involve significant resource costs for systems, internal control and personnel. We believe that the vast majority of these costs will be permanent.

Costs will be incurred in the following categories:

- Training for accountants and actuaries;
- Training for management to understand and use the new and different financial outputs of the proposed model;
- Training of other users of financial statements;
- Actuarial systems, procedures and professional standards to move from the best estimate basis of reserving to the stochastically determined unbiased, probability weighted cash flow model;
- Accounting systems to capture information at a more granular level for a significant number of portfolios and cohorts including original yield curves, current yield curves, and the effects of these changes;
- Accounting systems to recognize the earning of premium from the pro-rata method to one based on the reduction in remaining coverage;
- Accounting systems to capture the expected returnable amount, apply it to claims payments and IBNR increases and otherwise implement the significant changes relating to separating this component in the performance statement;
- Develop new risk and pricing systems;
- Sox 404 related costs; and
- Internal and external audit costs

***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.*

We expect that the increased complexity and subjectivity of the information used in the measurement model and significant new disclosures will significantly increase audit costs versus auditing costs under current U.S. GAAP.

**Other Issues**

Some members believe that the requirement to revalue all foreign currency denominated (re)insurance balances, including non-monetary items, such as the liability for remaining coverage under the PAA approach (which now includes the balances previously known as the unearned premium reserve and deferred acquisition costs) introduces unnecessary complexity and volatility and does not provide useful information for the users of the financial statements. These members assert that these entries are purely accounting entries which reverse to zero over the contract period. As these items by definition are non-monetary, they do not convert to cash, and therefore are never realized. As such, any and all unrealized foreign exchange gains or losses recorded on these balances in interim periods are ultimately reversed and net to zero by the time liability for remaining coverage is fully earned.

**Conclusion and Recommendations**

We appreciate the substantial efforts of the FASB and the IASB to develop their respective exposure drafts and support your objective of achieving an acceptable and converged global accounting standard for insurance contracts. We value the opportunity to comment on this very important document and look forward to evaluating related future guidance.

Thank you for your review and consideration of this letter. Should you have questions or require further information regarding this letter, please direct all communications to me.

Sincerely,

Joseph B. Sieverling
Reinsurance Association of America