AMERICAN ACADEMY of ACTUARIES

February 4, 2009

Hans van der Veen
International Accounting Standards Board (IASB)
30 Cannon Street
London, EC4M 6XH
United Kingdom
Via email: hvanderveen@iasb.org

Re: Measurement Attribute for Insurance Contracts and the Revenue Recognition Discussion Paper

Dear Hans,

One of the important issues of concern to those who have followed the IASB's Insurance Contracts project is how it would interact with other important projects currently underway. One of the most important such projects is the Revenue Recognition project, and its recently released Discussion Paper (the RRDP) demonstrates how important those interactions can be. While our review of the RRDP is just beginning, the Financial Reporting Committee of the American Academy of Actuaries[1] has developed some initial comments on how the insurance project might be able to use concepts from the RRDP. We thought these preliminary comments would be helpful to you at this juncture in preparing for future discussions of the IASB on measurement attributes for insurance contracts.

While we have not worked out in detail all the implications of the RRDP, and therefore reserve the right to adjust our comments on it in the future, we do have the following tentative observations:

1) The RRDP treats the contract as a whole and indicates that it is the contract that is the asset or liability rather than individual cash flows. (S14-16) We think this is the best overall approach to measurement of insurance contracts as well.
2) We view the insurance contract as providing the service of insurance protection and would therefore not consider the actual payment pattern of claims in recognizing revenue. We believe this is fully consistent with the intent of the RRDP. A separate accounting standard for reported claim liabilities would be needed, probably as part of the Insurance Contracts project.
3) We think that the concept of calibrating obligations to consideration at time zero is acceptable, particularly for single-premium and short-term non-life contracts.

[1] The American Academy of Actuaries ("Academy") is a 16,000-member professional association whose mission is to assist public policymakers by providing objective expertise and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States. Academy members are highly trained practitioners in mathematical and statistical approaches to quantifying risk, practicing in the insurance industry as well as the broader financial services industry.

The Academy's Financial Reporting Committee ("Committee") is comprised of members from across the spectrum of actuarial practice, including life insurance, property/casualty insurance, health insurance, and pensions. Committee members apply their skills to analysis of public policy relating to company financial statements, taking into account different perspectives from the various roles that actuaries may play, including those of preparer, auditor's expert, and user.

4) We have concerns with how the RRDP would be extended to recurring premium contracts, since the RRDP specifically does not address the measurement of rights under contracts. We believe that a resolution of this issue is possible following principles consistent with those set forth for obligations. Our initial thoughts on the subject are outlined below:
    a. The RRDP refers to the three building blocks included in the Insurance Contracts Discussion Paper as the measurement basis for performance obligations. We are comfortable with the description in the RRDP of those building blocks; although we might want some additional guidance when we discuss insurance obligations in more detail. We note that these descriptions are more general than those in the Insurance Contracts Discussion Paper and we think this is preferable.
    b. It would seem logical to us, therefore, to treat future rights in the same manner, namely they should:
        i. Include the best estimate of expected future incomes; and
        ii. Be discounted for the time value of money.
    c. It would make sense to us, therefore, to calibrate the present value of all considerations to the present value of all obligations under the contract and allow a single margin to achieve no gain or loss at issue.
    d. One concern we do have with this treatment is that it could result in significant up-front losses for most life insurance contracts and some non-life contracts as well, since it apparently does not allow recognition of high first-year costs in estimating the year-one obligation. There are several ways this could be addressed in an Insurance Contracts financial reporting standard. Some possibilities are:
        i. Allow calibration to the present value of considerations less first year expenses, thereby making the measurement of the contract an asset at issue to offset the first year expenses;
        ii. Allow an asset to be established for the value of the policyholder relationship or some similar asset; or
        iii. Allow all expenses to be included in the measurement of the performance obligation. We note that most of the expenses that cause a loss “at issue” for insurance contracts actually are incurred only once the contract is effective. This is different from the types of acquisition expenses described in the RRDP that are incurred prior to the contract becoming effective.

    There may be more possibilities than the three listed above, and we are not endorsing any particular treatment at this time.
5) We are also concerned about the lack of remeasurement of performance obligations (and presumably rights) under a contract. In particular, this would not work well for an embedded option in an insurance contract (or for a standalone option of any type). We strongly recommend, therefore, that an Insurance Contracts financial reporting standard provide for remeasurement of the expected costs (and rights) on a regular basis.

We hope that these initial comments are useful to you in preparing for IASB discussions on the Insurance Contracts project. As we noted, this is not intended to be a complete discussion of either the RRDP or how it would apply to insurance contracts. It is simply our initial reaction on a short timeframe. If you would like to discuss any of these points further, feel free to contact us.

Sincerely,

Rowen B. Bell
Chairperson, Financial Reporting Committee
American Academy of Actuaries

Cc: Jeffrey Cropsey (FASB)
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