October 30, 2003

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London EC4M 6XH United Kingdom

Dear Sir David and Members of the Board:

The American Council of Life Insurers (ACLI) welcomes the opportunity to comment on ED 5 Insurance Contracts. As you are aware, the ACLI is keenly interested in the ongoing Insurance Contracts Project. We have submitted several comment letters to the Board, both on a stand-alone basis and jointly with various international trade associations. We have also submitted a research report on various accounting methodologies to the Board that was prepared jointly with the International Actuarial Association (IAA) and conducted an educational session with several board members on the findings in this report.

We offer the following comments to the Board for consideration in their deliberations on phase I.

Question 1 - Scope (a)

The Exposure Draft proposes that the IFRS would apply to insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. The IFRS would not apply to accounting by policyholders (paragraphs 2-4 of the draft IFRS and paragraphs BC40-BC51 of the Basis for Conclusions).

The Exposure Draft proposes that the IFRS would not apply to other assets and liabilities of an entity that issues insurance contracts. In particular, it would not apply to:

(i) assets held to back insurance contracts (paragraphs BC9 and BC109-BC114). These assets are covered by existing IFRSs, for example, IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property*.

(ii) financial instruments that are not insurance contracts but are issued by an entity that also issues insurance contracts (paragraphs BC115-BC117).

Is this scope appropriate? If not, what changes would you suggest, and why?

Response:

We do not agree with the decision to exclude specific guidance for assets backing insurance contracts. As the ACLI illustrated in their joint report with the IAA, inconsistent measurement of assets and liabilities will, in many cases, lead to financial noise that can misrepresent business reality. In paragraph BC110 the Board acknowledges this concern, yet concludes that they were not persuaded by the arguments raised about the effects of a possible mismatch in the financial statements. We believe that the effects of this mismatch far outweigh the difficulties of establishing a suitable alternative.

We offer two alternatives to the Board to provide for consistent valuation of assets and liabilities. The first alternative would be to create a new category of investments in IAS 39, "Assets backing insurance liabilities". This category of assets would consist of fixed income assets whose expected cash flows support the expected cash flows of the corresponding insurance liabilities. These assets would be carried at amortized cost, similar to assets classified as held-to-maturity. The second alternative would be to relax the criteria for sales of the held-to-maturity category. Sales of held-to-maturity assets would be allowed, without tainting the portfolio, to the extent that they can be shown to be in response to changes in expected liability cash flows.

While the Board continues on the path to an asset/liability model (BC6) which necessitates consistent accounting treatment for phase II, we do not understand why the Board would dismiss the inconsistent measurement as not being important in phase I.

Question 1 - Scope (b)

The Exposure Draft proposes that weather derivatives should be brought within the scope of IAS 39 unless they meet the proposed definition of an insurance contract (paragraph C3 of Appendix C of the draft IFRS). Would this be appropriate? If not, why not?

Response:

We have no comment on this issue.

Question 2 – Definition of insurance contract

The draft IFRS defines an insurance contract as a 'contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary' (Appendices A and B of the draft IFRS, paragraphs BC10-BC39 of the Basis for Conclusions and IG Example 1 in the draft Implementation Guidance).

Is this definition, with the related guidance in Appendix B of the draft IFRS and IG Example 1, appropriate? If not, what changes would you suggest, and why?

Response:

The draft IFRS definition is confusing when it refers to the policyholder and the beneficiary. The definition states that the policyholder or beneficiary is to be compensated if the uncertain future event adversely affects the policyholder or beneficiary. While it is agreed that either the policyholder or a beneficiary would be compensated (obviously the beneficiary would in the case of a death), it is not clear who must have the adverse impact, the policyholder or the beneficiary. It is assumed that the intent is for the policyholder to have had the adverse impact, and the definition should be adjusted to eliminate the second reference to the beneficiary.

For contract holders who have whole life contracts and can show proof of a terminal illness, living benefit contracts pay portions of the face amount of contract holders' life insurance policies while they are still living. The payments made before death on these contracts are called viatical settlements. These contracts are classified as insurance contracts under U.S. GAAP, since they are part of the original contract. For completeness, we suggest an example of these types of contracts be included in the implementation guidance.

The draft IFRS seems to be in relative agreement to U.S. GAAP with respect to the determination of the significance of insurance risk as stated in SFAS 97 *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, paragraphs 7 and 8; and AICPA Statement Of Position 03-01, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*, paragraphs 24 and 25. All life insurance risk significance tests are based on the present value of cash flows, which can be paid out under the contract when an insurance event occurs as compared to the present value of all contractual cash flows. However, the draft IFRS deviates from U.S. GAAP in that a contract may switch from one accounting model, FRS 39, to another, the draft IFRS, if a significant change in the present value of the issuer's net cash flows becomes a plausible possibility. U.S. GAAP specifically prohibits reclassification after the initial classification determination at the inception of the contract. While a continued assessment of a contract may ensure the most faithful representation of the contract in the financial statements, this deviation from U.S. GAAP is most appropriate for phase II, rather than create a difference in reporting models for contracts which may switch classification during the time between phase I and phase II.

Examples 1.5 and 1.6 in the IG are incomplete. Since most deferred annuity contracts offer both life and non-life contingent options at annuitization, it is not clear why examples are included for those that only offer annuitizations with life-contingencies. The deferred annuity contracts have annuitization options similar to the provisions as stated in example 2.6 (c).

We agree with the stated intent of the IASB Board to keep the phase I definition of insurance contracts and carry it into phase II. We would not support a phase I definitional change that would cause contracts to be handled differently (under a different model) in phase II.

Question 3 – Embedded Derivatives (a)

IAS 39 Financial Instruments: *Recognition and Measurement* requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in profit or loss. This requirement would continue to apply to a derivative embedded in an insurance contract, unless the embedded derivative:

(i) meets the definition of an insurance contract within the scope of the draft IFRS;

(ii) is an option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate).

However, an insurer would still be required to separate, and measure at fair value:

(i) a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in an equity or commodity price or index; and

(ii) an option to surrender a financial instrument that is not an insurance contract.

(paragraphs 5 and 6 of the draft IFRS, paragraphs BC37 and BC118-BC123 of the Basis for Conclusions and IG Example 2 in the draft Implementation Guidance)

Are the proposed exemptions from the requirements in IAS 39 for some embedded derivatives appropriate? If not, what changes should be made, and why?

Response:

We do not agree that guidance to separate embedded derivatives and measure them at fair value with changes reported in profit or loss should be included in phase I. The Board should not make piecemeal changes to recognition and measurement practices in phase I as many aspects of accounting for insurance contracts are interrelated with aspects that will not be completed until phase II.

Insurance contracts are fundamentally different from financial instruments. Components of an insurance contract cannot be separated and traded in the same way as components of a bond can be separated. As such, we believe that a derivative embedded in an insurance contract must be regarded as closely related to the insurance contract, which is considered the host.

Separating embedded derivatives will be complicated, costly and administratively burdensome. While companies currently following US GAAP are subject to the embedded derivative rules contained in FAS 133, the IAS 39 guidance regarding the types of features that are embedded derivatives that must be bifurcated is different in certain respects from FAS 133 (particularly as IAS 39 does not contain a grandfathering provision similar to that provided in FAS 133). This will likely result in an expansion of the number of embedded derivatives that companies are required to bifurcate and account for at fair value under IAS 39 as compared to FAS 133. This will require the design and testing of new systems and the development of valuation models that will likely be changed as a result of phase II.

If the Board ultimately decides to include this requirement in the final standard, we do agree that the proposal should not apply to surrender values in traditional life insurance contracts and options to surrender an insurance contract for a fixed amount, even if the exercise price differs from the carrying amount of the host insurance liability. It should also not apply to surrender values of non-traditional life insurance and annuity contracts such as Universal Life and Variable Life and Annuities. Setting a value on those items is an integral part of what needs to be resolved in phase II.

Question 3 – Embedded Derivatives (b)

Among the embedded derivatives excluded by this approach from the scope of IAS 39 are items that transfer significant insurance risk but that many regard as predominantly financial (such as the guaranteed life-contingent annuity options and guaranteed minimum death benefits described in paragraph BC123 of the Basis for Conclusions). Is it appropriate to exempt these embedded derivatives from fair value measurement in phase I of this project? If not, why not? How would you define the embedded derivatives that should be subject to fair value measurement in phase I?

Response:

We agree with this exception.

Question 3 – Embedded Derivatives (c)

The draft IFRS proposes specific disclosures about the embedded derivatives described in question 3(b) (paragraph 29(e) of the draft IFRS and paragraphs IG54-IG58 of the draft Implementation Guidance). Are these proposed disclosures adequate? If not, what changes would you suggest, and why?

Response:

The exposure draft proposes disclosure of information about material exposures to interest risk or market risk under embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value. We do not believe an explicit requirement to disclose embedded derivatives is necessary. However, we do believe that the financial statement should include a discussion of the risk exposures of the business. The required disclosures should provide meaningful information that assists users of financial statements in assessing the extent of the risks.

Question 3 – Embedded Derivatives (d)

Should any other embedded derivatives be exempted from the requirements in IAS 39? If so, which ones and why?

Response:

See response to question 3(a)

Question 4 – Temporary exclusion from criteria in IAS 8 (a)

Paragraphs 5 and 6 of [the May 2002 Exposure Draft of improvements to] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify criteria for an entity to use in developing an accounting policy for an item if no IFRS applies specifically to that item. However, for accounting periods beginning before 1 January

2007, the proposals in the draft IFRS on insurance contracts would exempt an insurer from applying those criteria to most aspects of its existing accounting policies for:

(i) insurance contracts (including reinsurance contracts) that it issues; and

(ii) reinsurance contracts that it holds.

(paragraph 9 of the draft IFRS and paragraphs BC52-BC58 of the Basis for Conclusions).

Is it appropriate to grant this exemption from the criteria in paragraphs 5 and 6 of [draft] IAS 8? If not, what changes would you suggest and why?

Response:

We agree with the decision to exempt insurance contracts from paragraphs 5 and 6 of the draft IAS 8. Given the approach being adopted, these exemptions are necessary. We do not however agree with the inclusion of a date for the expiration of this exemption. The expiration of this exemption should be dependent on the completion of phase II, not an arbitrary date when phase II is hoped to be completed.

Question 4 – Temporary exclusion from criteria in IAS 8 (b)

Despite the temporary exemption from the criteria in [draft] IAS 8, the proposals in paragraphs 10-13 of the draft IFRS would:

(i) eliminate catastrophe and equalization provisions.

(ii) require a loss recognition test if no such test exists under an insurer's existing accounting policies.

(iii) require an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire, and to report insurance liabilities without offsetting them against related reinsurance assets (paragraphs 10-13 of the draft IFRS and paragraphs BC58-BC75 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you propose, and why?

Response:

We have no comment on these issues.

Question 5 – Changes in accounting policies

The draft IFRS:

(a) proposes requirements that an insurer must satisfy if it changes its accounting policies for insurance contracts (paragraphs 14-17 of the draft IFRS and paragraphs BC76-BC88 of the Basis for Conclusions).

(b) proposes that, when an insurer changes its accounting policies for insurance liabilities, it can reclassify some or all financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognized in profit or loss (paragraph 35 of the draft IFRS).

Are these proposals appropriate? If not, what changes would you propose and why?

Response:

We agree with the conclusions reached in paragraphs 14 and 15 of the exposure draft. However, we do not agree with the conclusions reached in paragraph 16. The current paragraph 16 should be changed to allow insurers to convert their financial reporting policies to an established accounting policy, such as US GAAP.

Question 6 – Unbundling (a)

The draft IFRS proposes that an insurer should unbundle (i.e. account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet (paragraphs 7 and 8 of the draft IFRS, paragraphs BC30-BC37 of the Basis for Conclusions and paragraphs IG5 and IG6 of the proposed Implementation Guidance).

Is unbundling appropriate and feasible in these cases? If not, what changes would you propose and why?

Response:

Unbundling should not be required for insurance contracts. The effect of unbundling would be to account for the insurance component as an insurance contract and the deposit-like component under IAS 39. This has the potential of creating a complex Standard with parts of a contract accorded different accounting treatment. Insurance liabilities should be treated as a whole rather than split into pieces. Requiring unbundling ignores the substance and form of an insurance contract. Once the contract is issued, the insurer cannot unilaterally terminate the agreement or sell parts of it. The components are closely related both in policy structure and in the way they are priced. Cash flows from all components affect the settlement of the contract.

While attempting to demonstrate unbundling, the example contained in the IG, paragraphs 5-6, also serves as an example why it is inappropriate. The unbundled balances in the no claims scenario can't be known with certainty until the end of the five-year term. Assuming the contract qualifies as insurance, there must exist uncertainty about the timing and amount of the expected claims. At the end of year one, as well as all subsequent years, the example fails to take into account the expected future claims. No guidance is provided regarding the measurement of the remaining insurance liability and the effect the deposit component has on the insurance liability. Equally important is that no guidance is provided for the income and benefit recognition under this scenario. Is the entire "10" received each year recorded as premium income or is the premium reduced by the deposit balance? Unbundling fails to recognize the nature of the insurance contract and the relationship of all elements of the contract.

In addition to being complex, the inclusion of unbundling in phase I will increase the administrative burden especially for those who will be preparing financial statements in accordance with the IFRS in January 2005. Unbundling has the potential to pre-determine the outcome of phase II before it is discussed. Therefore, we strongly recommend that the Board remove any unbundling guidance from the final IFRS.

Question 6 – Unbundling (b)

Should unbundling be required in any other cases? If so, when and why?

Response:

See response to question 6(a) above.

Question 6 – Unbundling (c)

Is it clear when unbundling would be required? If not, what changes should be made to the description of the criteria?

Response:

It is not clear when unbundling would be required. In the Basis for Conclusions, the Board acknowledges that there is no clear conceptual line between the cases when unbundling is required and the cases when unbundling is not required. The Basis for Conclusions also states "…the draft IFRS proposes unbundling only when it is easiest to perform and the effect is likely to be greatest..." This will lead to diversity in practice. This may result in similar insurance contracts being accounted for differently depending on the insurers perception of whether unbundling is easy to perform.

Question 7 – Reinsurance purchased

The proposals in the draft IFRS would limit reporting anomalies when an insurer buys reinsurance (paragraphs 18 and 19 of the draft IFRS and paragraphs BC89-BC92 of the Basis for Conclusions).

Are these proposals appropriate? Should any changes be made to these proposals? If so, what changes and why?

Response:

The accounting theory provided in the proposed guidance for reinsurance is subject to the same issues as other items contined in ED 5 and commented on above. This is due primarily to the attempt by the IASB to implement an incomplete accounting model. The proposed accounting guidance will result in a measurement mismatch of insurance assets and liabilities arising from reinsurance transactions because it requires measurement of liabilities at cost and assets, generally, at fair value. This situation will result in financial statements that do not reflect a balanced view of the reinsurance company and may adversely impact the insurance and reinsurance markets.

The valuation of reinsurance assets independently from the insurance liabilities implies that the uncertain cash flows to be received by the holder of the asset should be valued less than the estimated cash flows, discounted for present value, due to the market value margins that would apply. This independent valuation of the reinsurance asset would ignore the direct relationship between the reinsurance asset cash flows with the cash flows from the corresponding insurance liabilities. The uncertainties in the insurance liability cash flows associated with the reinsured events can be reduced, or eliminated, by the cash flows from the reinsurance assets. Cash flows from a ceded reinsurance contract provide risk mitigation that is a direct function of specific cash flows from the insurance liabilities. The independent valuation of reinsurance assets versus insurance liabilities will not reflect this relationship and will cause an unrealistic financial representation of the impact of reinsurance.

We strongly recommend that the IASB modify the proposed IFRS to treat ceded reinsurance in a manner that would allow the valuation of reinsurance assets to reflect the economic reality of the transaction. The current proposal would result in a reinsurance asset having a greater economic value to a company than the fair value of the estimated reinsurance assets. To the extent that the uncertainty in the cash flows from the insurance liabilities is offset by reinsurance recoveries, the valuation of the reinsurance assets should reflect the benefit of the relationship of the reinsurance cash flows to the insurance liability cash flows. We suggest that this could be accomplished by deferring any valuation guidance on reinsurance to phase II. The presentation of reinsurance purchased as assets could still be included in phase I using local GAAP with respect to the valuation of reinsurance assets and the insurance liabilities, without any deduction for reinsurance.

Question 8 - Insurance contracts acquired in a business combination or portfolio transfer

IAS 22 *Business Combinations* requires an entity to measure at fair value assets acquired and liabilities assumed in a business combination and ED 3 *Business Combinations* proposes to continue that long-standing requirement. The proposals in this draft IFRS would not exclude insurance liabilities and insurance assets (and related reinsurance) from that requirement. However, they would permit, but not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

(a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and

(b) an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset would be excluded from the scope of IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. Its subsequent measurement would need to be consistent with the measurement of the related insurance liability. However, IAS 36 and IAS 38 would apply to customer lists and customer relationships reflecting the expectation of renewals and repeat business that are not part of the contractual rights and obligations acquired.

The expanded presentation would also be available for a block of insurance contracts acquired in a portfolio transfer (paragraphs 20-23 of the draft IFRS and paragraphs BC93-BC101 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you suggest and why?

Response:

We support the requirement that a liability be measured in accordance with the insurer's accounting policies for insurance contracts that it issues. As the Board has not developed any measurement guidance or standard for the valuation of insurance liabilities, requiring any valuation of liabilities at fair value would be inconsistent and potentially confusing to financial statement users.

Question 9 – Discretionary participation features

The proposals address limited aspects of discretionary participation features contained in insurance contracts or financial instruments (paragraphs 24 and 25 of the draft IFRS and paragraphs BC102-BC108 of the Basis for Conclusions). The Board intends to address these features in more depth in phase II of this project.

Are these proposals appropriate? If not, what changes would you suggest for phase I of this project and why?

Response:

We do not have any objections to the short-term proposals offered on discretionary participation features.

Question 10 – Disclosure of the fair value of insurance assets and insurance liabilities

The proposals would require an insurer to disclose the fair value of its insurance assets and insurance liabilities from 31 December 2006 (paragraphs 30 and 33 of the draft IFRS, paragraphs BC138-BC140 of the Basis for Conclusions and paragraphs IG60 and IG61 of the draft Implementation Guidance).

Is it appropriate to require this disclosure? If so, when should it be required for the first time? If not, what changes would you suggest and why?

Response:

In previous letters about proposed disclosures for phase I, we expressed our disagreement with a requirement to disclose fair value information about insurance assets and insurance liabilities until phase II is complete. We are now more convinced that the fair value disclosure be removed since the effective date is 2006. Without some knowledge about the measurement criteria, which won't be available until phase II, "…to encourage insurers to begin work on fair value systems…", as noted in BC138, is not a compelling argument to conclude that the disclosure is currently necessary. Insurers have considerable experience about the methods and procedures related to discounting cash flows that would enable them to be responsive to any fair value disclosure if that is the ultimate conclusion. Expecting insurers to begin work on an unknown objective would be costly and quite frankly a waste of time. We strongly recommend that the fair value disclosure requirement be removed from phase I and included in phase II. The disclosure could serve as part of the transition if fair value measurement is required.

Question 11 – Other disclosures (a)

The Exposure Draft proposes requirements for disclosures about the amounts in the insurer's financial statements that arise from insurance contracts and the estimated amount, timing and uncertainty of future cash flows from insurance contracts (paragraphs 26-29 of the draft IFRS, paragraphs BC124-BC137 and BC141 of the Basis for Conclusions and paragraphs IG7-IG59 of the draft Implementation Guidance).

Should any of these proposals be amended or deleted? Should any further disclosures be required? Please give reasons for any changes you suggest.

To a large extent, the proposed disclosures are applications of existing requirements in IFRSs, or relatively straightforward analogies with existing IFRS requirements. If you propose changes to the disclosures proposed for insurance contracts, please explain what specific attributes of insurance contracts justify differences from similar disclosures that IFRSs already require for other items.

Response:

While we generally support the objectives of the disclosures contained in paragraphs 26 and 28 we have comments and recommendations about the details contained in paragraphs 27 and 29.

Paragraph 27. c. requires disclosure about the process used to determine the assumptions. We disagree with this requirement since the process and modeling techniques used by insurers to measure insurance liabilities is complex requiring the skills of qualified actuaries. The disclosures required to comply with IG 20 would be costly to produce and not very useful. As noted in previous correspondence, insurers would most likely respond by disclosing highly summarized information that would rarely change, offering little value to users. We believe it's the assumptions actually used that are relevant, not the path taken to arrive at them. The challenge for insurers will be to meet the requirements and disclose meaningful information without the undesirable consequence of disclosing proprietary or confidential information. We recommend the replacing of paragraph 27.c. with a combination of IG 20.h. and 22 as follows:

> "disclose assumptions at a level of aggregation consistent with the manner in which the business is managed along with the nature and extent of material uncertainties affecting those assumptions."

The requirements of paragraphs 27.d. and e. and the corresponding Implementation Guide sections IG 24-30, seem to be closely related. Some of the requirements are met by the presentation of information in the financial statements, e.g., the change in liabilities and reinsurance assets. We recommend two changes. First, IG 26 should be included in the disclosure rather than in the IG. Secondly, 27.d. and e. should be combined as follows.

> "the effect of material changes in assumptions and related changes in insurance liabilities (before and after the impact of reinsurance), and insurance assets, showing separately the effect of each material change."

The requirements of paragraphs 28 and 29 relate to the amount, timing and uncertainty of cash flows. However, paragraph 29 appears to go well beyond the intended topic. While we support some disclosure about risk management, we believe it should be a separate disclosure. Risk management related to insurance contracts should cover three broad categories:

1. Policies for accepting insurance risk, e.g., retention limits
2. Concentration of risk
3. Use of reinsurance to manage risk

The requirements outlined in paragraph 29 (b) seem to be too broad to be meaningful. Some might argue that all contract terms and conditions could materially affect cash flows. Would compliance require attaching sample contracts to the financial statements? In contrast, IG 31-49 provide significant detail that makes compliance overly burdensome. For example, IG 39 requires net cash flow disclosure by classes into six periods. An insurer's cash flows are influenced not only by existing business but new business as well. To disclose cash flows from existing business only would not be meaningful to users, in fact potentially misleading, because it would not be a predictor of the insurance cash flows. While we recognize that this disclosure is similar to requirements contained in IAS 39, it is not relevant for insurance contracts because of the uncertainty of cash flows. We would agree that an estimate of the insurance cash flows in the subsequent year and the variability around the estimate could be useful.

Question 11 – Other disclosures (b)

The proposed disclosures are framed as high-level requirements, supplemented by Implementation Guidance that explains how an insurer might satisfy the high level requirements.

Is this approach appropriate? If not, what changes would you suggest, and why?

Response:

While we tend to support a "principles based" approach in the development of standards, sufficient guidance must be provided to ensure consistency and comparability. The disclosure guidance in its present form is too "high level" to ensure either consistency or comparability. The fact that the Implementation Guidance is not part of the Standard may make its usefulness problematic. If the purpose of Implementation Guidance is to be informative rather than authoritative, great care should be taken regarding its content. The Guidance cannot contradict nor should it expand the requirements of the Standard. For these reasons, we have made recommendations in our response to question 11(a) where sections of the Guidance should be moved to the Standard. Including examples or supporting information in the Appendix to the Standard would be useful.

<u>Question 11 – Other disclosures (c)</u>

As a transitional relief, an insurer would not need to disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed IFRS (paragraphs 34, BC134 and BC135).

Should any changes be made to this transitional relief? If so, what changes and why?

<u>Response:</u>

In the U.S., claims development disclosure is associated with property/casualty insurance primarily because of the uncertainty of the amount and timing of the claim. The benefits associated with life insurance are known, but the timing is uncertain. Consequently, we believe this disclosure would not apply to life contracts. To avoid confusion, we recommend that additional language should be added to clarify the intent of this disclosure.

<u>Question 12 – Financial guarantees by the transferor of a non-financial asset or liability</u>

The Exposure Draft proposes that the transferor of a non-financial asset or liability should apply IAS 39 Financial Instruments: Recognition and Measurement to a financial guarantee that it gives to the transferee in connection with the transfer (paragraphs 4(e) of the draft IFRS, C5 of Appendix C of the draft IFRS and BC41-BC46 of the Basis for Conclusions). IAS 39 already applies to a financial guarantee given in connection with the transfer of financial assets or liabilities.

Is it appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assets or liabilities? If not, what changes should be made and why?

<u>Response:</u>

We have no comment on this issue.

<u>Question 13 – Other comments</u>

Do you have any other comments on the draft IFRS and draft Implementation Guidance?

<u>Response:</u>

The ACLI/IAA joint report evaluated and discussed two significant issues. First, inconsistent measurement of assets and liabilities will, in many cases, produce "financial noise" that can misrepresent business reality. Second, an accounting model that establishes artificial constraints can lead, in many cases, to unrepresentative results. The current exposure draft does not provide any guidance to alleviate these concerns. By not allowing for another asset category for assets held to back insurance liabilities, nor any relaxing of the constraints on a held-to-maturity portfolio, the Board has effectively dismissed any concerns over an insurer's mismatched balance sheet. The adoption of either of these concepts would alleviate the mismatch during phase I and provide a model that could be analyzed during the deliberations on phase II.

Similarly, an example of an artificial constraint that the Board is implementing is that of a deposit floor. In the Basis for Conclusion, the Board expresses its intent to modify IAS 39 to make clear that the fair value of a financial liability with a demand feature is not less than the amount payable on demand. The imposition of a requirement that the value of an insurance contract cannot be less than the amount payable on demand places a significant constraint on the valuation process. Comparing the amount payable on demand of an insurance contract to its fair value is not valid and the comparison should not be allowed to influence the measurement of the liability.

The ACLI and IAA have begun work on a second joint project, modeling the financial results of a universal life policy. We expect the findings of this project to once again highlight the financial noise created with an inconsistent measurement accounting method. Further, we expect other issues to arise with the introduction of new factors into the model, such as renewal premiums and non-guaranteed elements. When this joint report is completed, we will share our findings with the IASB and staff with the expectation of meeting to discuss our observations.

We are also concerned with the timeline for the completion of this phase and of the work on phase II. We are aware of the Board's heavy workload especially with respect to standards that need to be finalized within the next three to six months. Consequently, it is unlikely that the Board will find the time before the second quarter of 2004 to begin meaningful discussions about phase II measurement objectives. Because no accounting standard for insurance contracts based upon a fair value measurement model exists, we believe that the Board should subject any fair value measurement standard to rigorous testing. While the ACLI is not an advocate of fair value measurement for insurance contracts, we support many of the preliminary measurement principles, e.g., present value of expected future cash flows, which should also apply to an amortized cost (HTM) model. We strongly encourage the Board to develop both models (fair value and amortized cost), with similar principles and conceptually consistent with IAS 39.

Sincerely,

James F. Renz
Senior Accountant