AMERICAN ACADEMY of ACTUARIES

June 6, 2000

Sir Bryan Carsberg
The Secretary-General
International Accounting Standards Committee
166 Fleet Street
London EC4A 2DY
United Kingdom

Dear Sir Bryan:

The purpose of this letter is to present comments of the American Academy of Actuaries (the Academy) on Basic Issue 11, Fair Value Issues, of the Issues Paper on Insurance released for comment by the IASC Steering Committee on Insurance in November, 1999. The Academy anticipates providing the IASC with additional comments on other basic issues discussed in the Issues Paper.

The American Academy of Actuaries is the public policy organization for actuaries practicing in all specialties within the United States. A major purpose of the Academy is to act as the public information organization for the profession. The Academy is non-partisan and assists the public policy process through the presentation of clear and objective actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

We thank the IASC for this opportunity to comment on the Insurance Issues Paper. We strongly support the objective of improving accounting standards worldwide.

We have also participated in and are supportive of the efforts of the International Actuarial Association (IAA) to develop its comments on the Issues Paper.

For the convenience of readers of our comment letter, we have included the Basic Issue, the Sub-issues, and (*in italics*) the Tentative Views of the Insurance Steering Committee of the IASC. Our comments (labelled Academy View) follow the tentative view of the Steering Committee on each sub-issue.

## Fair Value Issues

**Basic Issue 11** **What Issues are Raised by the Use of Fair Value in the Measurement of Insurance Obligations?**

## Sub-issue 11A Are Insurance Contracts Financial Instruments?

### *Tentative Steering Committee View*

537. *In the Steering Committee's view, insurance contracts should be considered financial instruments. Insurance contracts may have non-financial attributes. However, any attempt to exclude them from consideration as financial instruments will lead to accounting differences between insurance contracts and other economically similar instruments. The Steering Committee acknowledges that viewing insurance contracts as financial instruments may lead to conclusions that differ from those that follow from a view of insurance contracts as service contracts.*

**Academy View on Sub-issue 11A:**

- Application of the definition of a financial instrument (paragraph 527) to an insurance contract would be made clearer if:

  a. the definition of a financial asset included contingent contractual rights, and

  b. the definition of a financial liability included contingent contractual obligations.

  Without this clarification, it is not clear that an insurance contract would be contained in the definition of a financial instrument. The purchaser of an insurance contract often does not receive an absolute contractual right to receive cash or another financial asset from the insurer. The purchased contractual right to receive a financial asset is contingent upon the occurrence of some event specified in the contract.

- If insurance contracts are considered to be financial instruments and, as a result, accounted for in a manner different from service contracts, an opportunity will be created for accounting arbitrage. Some service contracts differ little in their economic effects from insurance contracts. If the accounting standards for the two types of contracts differ, similar economic events may receive contrasting accounting treatments.

- Paragraph 529 states:

  > "The problem has been that actuarial methodologies developed for making these estimates have not been consistent with accounting framework concepts and measurement principles. (6.25)"

  The actuarial profession is committed to high standards of professionalism in supporting the financial reporting process. We are not aware of situations in the United States where the actuarial work product employed in the financial reporting process is inconsistent with accounting framework concepts and measurement principles. We regularly work closely with the FASB and other accounting authorities to develop actuarial standards that support the effective implementation of accounting guidance, and we are confident that this cooperative process can be extended internationally.

## Sub-issue 11B Should Insurance Contracts be Included in a Fair Value Standard?

*Tentative Steering Committee View*

556. *The Steering Committee holds the following views, all in the assumed context of a future International Accounting Standard that requires all financial instruments to be measured at fair value:*

*(a) if the other enterprises use fair value for financial instruments, insurers should not be excluded;*

*(b) if all other financial assets and financial liabilities of an insurer are at fair value, insurance contracts should be at fair value;*

*(c) movements in the fair values of an insurer's financial assets and liabilities should be reported in a consistent manner. For example, if some movements in the fair value of assets are excluded from net profit or loss for the period and reported as a component of equity, accompanying movements in liabilities should be reported in the same fashion; and*

*(d) accounting for insurance contracts at fair value should be covered in the insurance standard, not in the financial instruments standard.*

557. *The Steering Committee assumes that, on the completion of this project, IASC will have adopted a comprehensive approach to reporting all financial instruments at fair value, with all movements in fair value reported in the income statement. The Steering Committee considers consistency between the treatment of assets and liabilities of an insurance enterprise a precondition for proper reporting. Therefore, the assets and liabilities arising out of insurance contracts should be measured at fair value, with all movements in fair value reported in the income statement.*

558. *The Steering Committee acknowledges that, at this time, it is often difficult to estimate the fair value of assets and liabilities created by insurance contracts on a reliable, objective, and verifiable basis. Therefore, the Steering Committee intends to develop further guidelines to address estimation. In the meantime, the Steering Committee would welcome any suggestions for those guidelines.*

**Academy View on Sub-issue 11B:**

- The Academy on a number of occasions has expressed its view that insurance liabilities and associated financial assets should be valued on a consistent basis with regard to fluctuations in the capital markets that could affect the value of financial instruments. Therefore, we agree that exempting only insurance liabilities from a fair value standard would be inappropriate.

- Paragraph 559 quotes paragraph 102 of IAS 39 as follows:

  "It is normally possible to estimate the fair value of a financial asset that an enterprise has acquired from an outside party. An enterprise is unlikely to purchase a financial instrument for which it does not expect to be able to obtain a reliable measure of fair value after acquisition."

  We disagree with this statement as applied to insurance contracts. For example, in general insurance an enterprise frequently purchases an insurance contract because it faces a risk it is unable to reliably measure and it wishes to replace this risk or uncertainty with the certain value of the insurance premium. The price such an enterprise is willing to pay may not be a good estimate of the fair value of the contingent obligation assumed by the insurer.

The discussion in paragraph 559 should be reconsidered in light of the discussion of Sub-issue 11C, which better reflects how insurance liabilities may be estimated.

- Paragraphs 558 and 560 mention the Steering Committee's intention of developing further guidelines to address the estimation of insurance liabilities.

  The Academy welcomes the Steering Committee's clarifications of the objectives of insurance liability estimation. Insurance liability estimation has long been the responsibility of qualified actuaries. In the U.S., this responsibility is supported by a strong network of standards of professional practice. We believe the Steering Committee should avoid implicitly setting actuarial standards or procedures within an accounting standard. Through our participation with the International Actuarial Association (IAA), the Academy will be glad to further assist the Steering Committee in its deliberations on this issue.

## Sub-issue 11C What should be the General Approach in Applying Fair Value to Insurance Contracts?

### *Tentative Steering Committee View*

566. *In the Steering Committee's view, the measurement approach described in IAS 37 provides a general model for estimating the fair value of most insurance obligations. The approach employs elements similar to those found in established techniques already used by insurers and actuaries. While there may be inconsistencies between the guidance found in IAS 37 and IAS 39, the Steering Committee observes that IAS 37 was designed to deal with liabilities that have uncertain cash flows - a common characteristic of most insurance liabilities.*

567. *The Steering Committee also notes the similarity between this approach and the present value techniques described in the recent FASB proposed Statement of Financial Concepts, Using Cash Flow Information and Present Value in Accounting Measurements. The Steering Committee observes that an insurer's internal estimates may sometimes provide the only available information about its liabilities, and notes the observation in paragraph 26 of the FASB's proposed Concepts Statement:*

> Adopting fair value as the objective of present value measurements does not preclude the use of information and assumptions based on an entity's expectations. An entity that uses cash flows in accounting measurements often has little or no information about the assumptions that marketplace participants would use in assessing the fair value of an asset or liability. In those situations, the entity must necessarily use the information that is available without undue cost and effort in developing cash flow estimates. The use of an entity's own assumptions about future cash flows is compatible with an estimate of fair value, as long as there are no contrary data indicating that marketplace participants would use different assumptions. If such data exist, the entity must adjust its assumptions to incorporate that market information.

**Academy View on Sub-issue 11C:**

- We agree.

## Sub-issue 11D Should the Fair Value of an Insurance Contract Include the Fair Value of Intangibles and Other Items Related to the Insurance Contract?

### *Tentative Steering Committee View*

576. *In the Steering Committee's view, the fair value of insurance assets and liabilities should represent the value of the financial assets or liabilities embodied in the insurance contract and should not include the value of intangible assets, renewal premiums, and related claims that would not otherwise meet the criteria for recognition in financial statements.*

**Academy View on Sub-issue 11D:**

- We believe that the Steering Committee's discussion of the fair value of renewal premiums should be clarified to indicate that the value of expected cash flows during renewal periods should be included in the fair value of a liability when the policyholder's guaranteed right to renew has a material, reasonably estimable value. In the paragraphs that follow, we discuss why we believe this clarification is required.

- The Steering Committee's tentative view is that under fair value, the value of renewal premiums is not included unless it would "otherwise meet the criteria for recognition in financial statements". We find the following three discussions of the criteria for recognition of renewal premiums.

  **I.** The executive summary of the Issues Paper states as follows:

  (e) the measurement of insurance liabilities should be based on current estimates of future cash flows from the current contract. Estimated future cash flows from renewals are:

  (i) included if the current contract commits the insurer to pricing for those renewals; and

  (ii) excluded if the insurer retains full discretion to change pricing.

  **II.** This subject is also referenced in sub-issue 6A:

  *191. The Steering Committee favours a closed book approach, as an open book approach would be inconsistent with the Framework. The closed book comprises existing contracts, including only those renewals where existing contracts commit the insurer to a specified pricing structure for the renewals. The closed book excludes both new contracts and other renewals of existing contracts.*

**III.** The issue is also discussed in sub-issue 8B:

> *399.* *In the Steering Committee's view, contracts that guarantee the policyholder's right to renew the contract and that restrict the insurer's ability to change the amount of renewal premiums create an asset or liability that would not exist in the absence of such guarantees or restrictions.*

- References I and III (i.e., the executive summary and sub-issue 8B) place emphasis on the insurer's ability to change *premiums.* In Reference II (sub-issue 6A), the emphasis is placed on committing the insurer to a specified *pricing structure*.

- We believe the following three contract examples will illustrate the clarification we recommend.

- **Example A:** Guaranteed Renewable Premium Health Insurance – These products are priced to have level premiums over their term, which may be 40 years or more. At the same time, these contracts give the company the right to increase premiums on any anniversary date without limit subject to regulatory approval. On one hand, the insurer has retained the right to change premiums. On the other, the insurer is committed to a particular pricing structure (level based on original issue age). For this type of policy, cash flows occurring during the renewal period **should** be considered in calculating the fair value of the liability because value is built up in the early years and used to cover costs in later periods. (This is a result of the level premium concept.) Without the clarification we recommend, the insurer's restricted ability to change premiums on renewal could be interpreted to preclude recognition of the expected renewal premiums on this contract.

- **Example B:** Indeterminate Level Premium Term Insurance – These products are also priced to have level premiums for their entire term (typically 10 to 20 years). The insurer retains the right to reprice the contract, up to a guaranteed maximum premium, on any anniversary date. The pricing assumptions of this contract presume it will be renewed and we believe its renewal premiums should be recognized in the fair value calculation. However, the criteria for recognition of the renewal premiums in determining fair value are unclear. On one hand, the insurer has retained the right to change premiums. On the other hand, there are guaranteed maximum premiums so the insurer does not have "full discretion" to change premiums.

- **Example C:** Deferred Annuities – Most deferred annuity contracts in the United States include a guaranteed monthly life income amount per $1,000 of accumulated fund value. Insurers are free to set current monthly income rates based on current market conditions, and current rates are generally more favorable than guarantees. However, when current rates are less favorable than these guarantees, the option to convert the accumulated fund value to a life income at the guaranteed rate has value.

  Many deferred annuity contracts also include the right to pay additional premiums. These contracts generally guarantee payment of a minimum interest rate on the accumulated fund value for the life of the contract, while offering a higher rate for the upcoming period (often one-year). Typically, the monthly life income guarantees discussed above apply to these additional premiums as well.

Both the income guarantees and the interest rate guarantees allow insurer discretion with regard to future changes, but only within contractual limits. We think estimated future cash flows from annuitization and from premiums should be reflected in determination of the fair value of liabilities because of the value of the associated guarantees.

- In each of the above examples, the policyholder has a unilateral right to renew, annuitize, or pay additional premiums. In each example, the policyholder may have something to lose by foregoing that option (e.g., by not exercising the right to renew). In the case of the guaranteed renewable health insurance policy, coverage after renewal will be at a “bargain” rate because of the value built up in the contract. Even if the policyholder were in perfect health, he or she would not generally be able to replace the policy at the same or a lower cost. The same is true of the indeterminate premium term policy. Even though the company has the right to increase premiums, there is a value built up in the current policy that would be forfeited if the policyholder surrendered it. Finally, with a deferred annuity, the insured loses the value of some or all guarantees if the policy is surrendered or renewal premiums are not paid.

- Accordingly, we believe that the value of expected cash flows during renewal periods should be included in the fair value of a liability when the policyholder's guaranteed right to renew has a reasonably estimable value.

## Sub-issue 11E Should the Fair Value of Insurance Contracts be based on Individual Contracts or Books of Similar Contracts?

### *Tentative Steering Committee View*

580. *In the Steering Committee’s view, any application of fair value to insurance contracts should continue the existing focus on groups of insurance contracts that have substantially the same contractual terms and were priced on the basis of substantially the same assumptions, rather than on individual insurance contracts (see Sub-issue 6A). Consistent with that view, insurance exposures that are not similar (for example, residential and marine exposures or professional liability and auto exposures) should not be combined.*

**Academy View on Sub-issue 11E:**

- We agree that any application of fair value to insurance contracts should focus on groups of insurance contracts. However, we disagree that the groups should be required to “have substantially the same contractual terms” and be “priced on substantially the same assumptions”. The actuarial profession is experienced in and has professional standards for assessing how to group insurance contracts in order to most effectively evaluate the associated assets and liabilities. For example, Actuarial Standard of Practice No. 36, *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves*, discusses such considerations. We suggest that the groups of contracts should represent similar underlying exposures to risk. The determination of similarity may depend upon the experience (on claims, surrenders, or other contractual features) of the insurance contracts in question.

## Sub-issue 11F Should the Fair Value of Insurance Contracts be Estimated using Entry or Exit Values and should the application of Fair Value Measurements result in a Gain or Loss on the Sale of Insurance Contracts?

*Tentative Steering Committee View*

597. *The Steering Committee considers exit value to be consistent with the definition of fair value, with the provisions of IAS 37, and with previous conclusions in this paper. The Steering Committee acknowledges that exit values may give rise to gains and losses upon the sale of insurance contracts, and that some may be concerned with that result.*

**Academy View on Sub-issue 11F:**

- We agree in principle with the Steering Committee's tentative view that fair values should be established as exit values, but we are concerned about the definition of "exit". There is a view that a reinsurance transaction could determine an exit price. However, in the United States the original insurer generally cannot completely divorce itself from the risk without the consent of the policyholder. In the event the reinsurer fails, the original insurer will still be responsible for benefits. In addition, in many cases, there may be a significant information gap between the original insurer and the reinsurer which may materially affect reinsurance pricing. For these reasons, reinsurance transactions do not necessarily indicate market based "exit" prices.

- We agree with the comment that an exit value basis may lead to gains or losses on sale. We see no problem with this possibility. In fact, such a result may be quite common under a system of accounting that does not focus on the matching of revenues and expenses. This gain or loss simply reflects the company's ability to gain a premium in the marketplace, or its need to sell at a discount.

- We also note that the use of exit value may result in negative liabilities. We feel this is appropriate. In many cases the initial costs of selling and underwriting an insurance contract are paid at the time of sale and recovered through margins in future contractual premiums. The present value of these future premium margins is a tangible asset (i.e., a negative liability) that is part of the fair value of the insurance contract liability. An example where negative liabilities arise is term life insurance shortly after a policy is issued. In this case the present value of future premiums is often greater than the present value of future claims, risk charges, and related costs because future premiums include a margin for recovery of previously incurred sales and underwriting costs. When the present value of future premiums is larger than the present value of future claims, risk charges, and related costs, the fair value of the liability is negative.

## Sub-issue 11G Should Fair Value of Insurance Contracts be Estimated using Rates of Return on the Insurer's Assets or using some other Discount Rate?

*Tentative Steering Committee View*

*610. Pending further discussion, the Steering Committee is evenly divided on whether the fair value of an insurer's liabilities incorporates the expected return on the insurer's assets. In the view of some members of the Steering Committee, such a measurement is consistent with the manner in which an insurance enterprise is managed. They also consider such a measurement consistent with the observed price of settlement transactions, to the extent they exist, and reinsurance transactions.*

611. *In the view of other members of the Steering Committee, the fair value of liabilities should not be affected by the type of assets held by the insurer or the return on those assets. In their view, the Steering Committee reached the appropriate conclusion in Basic Issue 5, and they see no justification for not extending that view to estimates of fair value.*

**Academy View on Sub-issue 11G:**

- A fair valuation basis for insurance contracts involves several parameters, of which the discount rate is just one. Another important parameter is the provision for risk. These parameters must be considered together. We agree that the yield rate on the insurer's own asset portfolio is not the appropriate discount rate unless the valuation basis includes some other adjustment for asset risk. For example, the yield rate on the insurer's own asset portfolio can be the appropriate discount rate if the correct adjustments are made to the cash flows being discounted.

- There are insurance contracts for which it is appropriate to consider the insurer's asset portfolio in determining the fair value of policy liabilities. Examples include variable contracts where policy liabilities directly reflect the investment performance of dedicated asset pools. Other contracts provide for experience refunds, dividends, or other non-guaranteed elements which relate to the investment earnings of the insurer's asset portfolio. Indeed, the future dividend scale for a mutual company is directly (often by law) related to its investment earnings.

- For liabilities with fair values not related to the performance of the company's assets, the issue remains that of determining an appropriate discount rate. Some individuals have suggested that the risk free rate be used. However, many experienced pricing and appraisal actuaries consider it inappropriate to use a risk free rate (where the risk free rate is defined as the government bond rate) as the discount rate even if risks are explicitly provided for in the discount model. An example is the market for Guaranteed Investment Contracts (GIC's) in the United States. If the risk free rate is used for discounting GIC liabilities, all active writers of these contracts are likely to show a liability at issue which exceeds the premium paid, creating an apparent financial loss on issue. This would not reflect the market realities, as these contracts are priced and sold using an interest rate assumption more in line with rates for investment-grade corporate bonds than for government bonds.

- Another objection to the use of a risk free rate is that the relationship between corporate debt rates and government bond rates is quite volatile. If liabilities are discounted at the government bond rate but the asset values reflect changing market spreads, the resulting inconsistency between the two sides of the balance sheet will introduce a great deal of artificial volatility into the financial results.

## Sub-issue 11H Should the Estimated Fair Value of Insurance Contracts include a Provision for the Risk Inherent in those Contracts?

### *Tentative Steering Committee View*

619. *Consistent with its view in Sub-issue 6F, the Steering Committee observes that the estimated fair value of an insurer's liability should include the premium that marketplace participants demand for bearing the uncertainty inherent in estimated future cash flows. The Steering Committee observes that this premium may be difficult to estimate, however, excluding the adjustment for risk may lead to measurements that make different liabilities, with different risk profiles, appear the same.*

**Academy View on Sub-issue 11H:**

- We agree that the estimated fair value of an insurer's liability should include a premium that reflects the uncertainty inherent in estimated future cash flows. However, since there is not in general a liquid market for insurance liabilities, measuring that premium by what marketplace participants demand is typically not a useable standard for the establishment of the fair value of insurance liabilities. One viable alternative would call for insurers to establish this premium by using modeling approaches that calibrate the cost of risk to information derived from other active markets that trade instruments with comparable risk structures.

- We believe this approach is consistent with the Steering Committee's tentative view on Sub-issue 11C, which concerns the general approach to applying fair value to insurance contracts. There it was noted that the use of an entity's own assumptions about future cash flows is compatible with an estimate of fair value, as long as there are no contrary data indicating that marketplace participants would use different assumptions. Actuaries are prepared to estimate the parameters of fair value models for insurance liabilities using data on marketplace transactions where possible, and using the insurer's own data (or other relevant data) where marketplace data is either not available or not representative of the liabilities of the insurer.

- Actuaries are experienced in modeling insurance liability cash flows and in evaluating the risk and uncertainty inherent in such models. In the United States, authoritative guidance is provided by the Actuarial Standards Board in Actuarial Standard of Practice (ASOP) No. 19, *Actuarial Appraisals*, and ASOP No. 20, *Discounting of Property and Casualty Loss and Loss Expense Reserves*. Both standards require actuaries to include risk margins that reasonably reflect the risks inherent in the item being discounted.

- Actuaries are prepared to estimate the fair value of insurance liabilities including the premium for the uncertainty in the estimated cash flows. Having said that, because fair value is not a current requirement for insurance liabilities in most countries, including the United States, implementation of a new standard should provide adequate lead time to allow revision of financial reporting processes. Should a new standard be released, we believe it likely that the Actuarial Standards Board and appropriate governing actuarial bodies in other countries would develop additional guidance to aid actuaries in applying their knowledge and experience to the task of estimating the fair value of insurance liabilities.

- We take this opportunity to express again our willingness and desire to work with the IAA and the Steering Committee in developing the accounting standards that will establish the objectives for actuaries modeling the fair value of insurance liabilities.

## Sub-issue 11I Should the Estimated Fair Value of Insurance Contracts reflect the Insurer's Credit Standing?

### *Tentative Steering Committee View*

*626. Questions about the role of an enterprise's credit standing (and changes in credit standing) in measuring liabilities extend beyond the measurement of insurance liabilities. The Joint Working Group on financial instruments is also considering these issues. The Insurance Steering Committee expects to monitor that activity and to co-ordinate its deliberations with those of the Joint Working Group.*

**Academy View on Sub-issue 11I:**

- We believe that the insurer's credit standing should not be reflected in the estimated fair value of the liabilities associated with insurance contracts.

- An insurer's financial assets are normally saleable in the capital markets, and we agree that the fair value of such assets normally reflects the credit standing of the issuer.

- However, an insurer's financial liabilities under its insurance contracts represent obligations to its policyholders which generally cannot be sold without the permission of the policyholder. Reinsuring an insurer's obligation typically hedges the insurer's financial risk associated with that obligation, but does not relieve the insurer of its obligation to satisfy that liability. Accordingly, it is generally not possible for an insurer to dispose of its liabilities in a manner that allows it to capture the hypothetical reduction in their value associated with its less than pristine credit standing.

- We note that the IASC objectives are to develop a single set of high quality, understandable and enforceable global accounting standards for general purpose financial statements that will help participants in the world's capital markets make sound economic decisions. We understand this to mean that existing and potential creditors (including policyholders) of insurance enterprises should benefit from these standards as well as existing and potential equity investors.

- For these creditors, and for the insurance regulators charged with aiding policyholders, reducing an insurer's liabilities to reflect a reduction in the insurer's credit standing will present a misleading picture of the insurer's ability to meet its obligations. In an extreme case, an insurer with substantial uncertainty as to its ability to satisfy its obligations may still have positive capital and thus apparently enough assets to satisfy its liabilities. However, the credit adjustment reflected in its liabilities could cause the implicit liability discount rate to far exceed the investment returns available to the insurer, causing the apparently solvent company to fall far short of paying its obligations as they come due.

- We are concerned that reflecting an insurer's credit standing in the fair value of its liabilities could be misleading to equity investors. A deterioration in an insurer's credit standing would cause a decrease in its liabilities and thus an increase in its earnings. Conversely, an insurer with an improving credit standing would find its earnings penalized. Since it is likely that in these cases investment analysts would reverse these effects, financial statement users would be better served if the adjustments of liabilities for credit standing were not made in the first place.

- Shareholders require information on a going-concern basis. Insurance companies are a viable going-concern only if the market values their promise to pay in the future. The principal product insurers provide is the promise to pay a future benefit, in return for cash paid to them up-front. An insurer that tries to leverage its weakened credit standing to reduce its insurance liability payments is effectively abandoning its going-concern franchise. In fact, a troubled insurer that is interested in protecting its going-concern franchise will need to do all it can to show that its reduced credit standing does not impair its ability to fully pay its claims. Therefore, reflection of credit standing in the fair value of insurance liabilities is an example of liquidation accounting, not going-concern accounting, hence not relevant to shareholders.

- In summary, the inability of an insurer to realize the "benefit" of its unfavorable credit standing, combined with the confusion for many financial statement users that would be caused by recognizing this impact and the mixing of going concern vs. liquidation accounting views, lead us to recommend that the insurer's credit standing not be reflected in the estimated fair value of the liabilities associated with insurance contracts.

## Sub-issue 11J Does a Fair Value Accounting System for Insurance Contracts include Deferred Acquisition Costs?

### *Tentative Steering Committee View*

*631. In the Steering Committee's view, the practice of reporting deferred acquisition costs as an asset, while consistent with some traditional accounting models, is not consistent with determining the fair value of the insurer's financial assets and liabilities. That determination is fundamentally a prospective computation unrelated to costs that the insurer may have incurred in selling insurance contracts. However, the Steering Committee observes that cash flow assumptions used in estimating fair value should reflect the fact that other marketplace participants may accept less to assume an insurer's obligations, because they would likely avoid the acquisition costs incurred by the insurer.*

**Academy View on Sub-issue 11J:**

- We agree.

**Sub-issue 11K** **Is the Embedded-Value Method an Appropriate Approach to use in Estimating and Reporting the Fair Value of Insurance Assets and Liabilities?**

*Tentative Steering Committee View*

*643. The Steering Committee considers that:*

*(a) embedded values should not be recognised as assets in financial statements as a means of correcting for inappropriate measurement of insurance liabilities;*

*(b) an insurer's rights under an insurance contract should be factored into the measurement of the insurer's net liability under the contract; and*

*(c) depending on the measurement basis adopted for insurance liabilities, there may be a need for disclosure of additional information about embedded values.*

**Academy View on Sub-issue 11K:**

- Embedded value techniques are not in common use in the United States. We understand that such techniques are commonly used in several other countries and recognize that they may be appropriate in some contexts.

**Sub-issue 11L** **Should Decisions about the Fair Value of an Insurer's Financial Assets and Liabilities be extended to other Assets and Liabilities of an Insurer?**

*Tentative Steering Committee View*

*652. Although it is not part of the Steering Committee's mandate to review accounting for property, plant and equipment generally, the Steering Committee believes that IASC should review accounting by insurers for these assets.*

**Academy View on Sub-issue 11L:**

- We agree.

To conclude our comments, we wish to thank once again the International Accounting Standards Committee for this opportunity to comment on the Insurance Issues Paper. The American Academy of Actuaries stands ready to provide whatever further assistance it can to the completion of your extremely worthwhile and challenging task. Please feel free to contact us through Sam Dillard, Financial Reporting Policy Analyst at (202) 785-7866 or at Dillard@actuary.org.

Sincerely,

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