1997

Comment letters on proposed the SOP on Deposit Accounting, 3162.DA

American Institute of Certified Public Accountants (AICPA)

AICPA

Date: November 20, 1997

To: Pat Meyer, Library

From: Andrea D. Smith, Accounting Standards

Subject: Comment letters on proposed the SOP on Deposit Accounting, 3162.DA

Enclosed are comment letters 1 -23 received in response to the, June 30, 1997 exposure draft, Proposed Statement of Position, *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk*.

The attached comment letters should remain on file in the AICPA Library for one year from the above date.

Attachment

List of Respondents to the Proposed SOP on Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk

Letter Number	Commentator	Affiliation
1	Florida Institute of CPA's	State Society
2	National Association of Insurance Commissioners	Professional Organization
3	Arkansas Society of CPA's	State Society
4	Louisiana Society of CPA's	State Society
5	Transatlantic Holdings, Inc.	Industry
6	Kramer Consulting Services, Inc.	Consultant
7	Reinsurance Association of America	Professional Organization
8	KPMG Peat Marwick LLP	Big 6
9	Coopers & Lybrand LLP	Big 6
10	Northeast Investors Growth Fund	Industry
11	CNA	Industry
12	Georgia State Society	State Society
13	American Insurance Association	Professional Organization
14	Travelers Group	Industry
15	American Academy of Actuaries	Professional Organization
16	Institute of Management Accountants	Professional Organization
17	Illinois CPA Society	State Society
18	Commercial Risk	Industry
19	Ernst & Young LLP	Big 6
20	Arthur Andersen LLP	Big 6

Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk (continued)

Letter Number	Commentator	Affiliation
21	General Reinsurance Corporation	Industry
22	New Jersey Society of CPA's	State Society
23	Price Waterhouse LLP	Big 6

FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

325 WEST COLLEGE AVENUE • P.O. BOX 5437 • TALLAHASSEE, FLORIDA 32314
TELEPHONE (904) 224-2727 • FAX (904) 222-8190

1

Rcv'd 8-19-97

August 8, 1997

Ms. Elaine Lehnert
Technical Manager, Accounting Standards-File 3162.DA
The American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms Lehnert:

The Accounting Principles and Auditing Standards Committee of the Florida Institute of CPAs (the "Committee") has reviewed and discussed the AICPA Exposure Draft for the Proposed Statement of Position on Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that Do Not Transfer Insurance Risk dated June 30, 1997. A summary of our comments follows.

The Committee members generally welcome the proposed statement of position as it will provide guidance in the accounting for the type of contracts covered by this document.

Issue 1: The Committee was of the opinion that the proposed SOP should apply to all enterprises. The Committee members did not perceive any reason to exclude enterprises other than insurance companies from the scope of the document. The Committee members were of the opinion that any enterprise dealing with the assumption or transfer of insurance risks should have the necessary documentation to enable them to account for such risks in accordance with generally accepted accounting principles. The Committee members did not perceive any additional burden to gather information or data to apply the provisions of this proposed SOP.

Issue 2: Although there are certain similarities in the four kinds of contracts identified in the SOP for which guidance has been provided, the Committee believed that the need for guidance for all four kinds of contracts identified in the proposed SOP was necessary.

Issue 3: There was certain level of discussion concerning the proposed accounting and reporting for the effect of initially adopting this SOP as a cumulative effect change in accounting principles in accordance with the provisions of APB No. 20. One member of the Committee was of the opinion that deposit accounting methodology should have always been the acceptable method in accounting for insurance and reinsurance contracts that do not transfer insurance risks; accordingly, the restatement approach would have been the methodology advocated by that individual. The remaining members of the Committee were in agreement with the cumulative effect approach proposed by the SOP.

1

Issue 4: The Committee believed that making the proposed SOP to be effective for financial statements for fiscal years beginning after December 15, 1998 was appropriate. The Committee believed that such effective date will provide ample time to the enterprises affected by this SOP to gather any additional information they may need and to assess and disclose the potential impact of this document.

* * * * * * * *

We appreciate the opportunity to share our views and concerns and to comment on the exposure draft. Members of our Committee are available to discuss any questions you may have about this communication.

Very truly yours,

Audrey Wilson Lewis, CPA, Chairman
FICPA Committee on Accounting
Principles and Auditing Standards

Task Force that Coordinated this Response:

Joy L. Gibson
Mario R. Lopez

NAIC

120 West 12th Street
Suite 1100
Kansas City, Missouri 64105-1925
816-842-3600

816-471-7004 Main Fax
816-842-9185 Financial Services & Research Fax

National
Association
of Insurance
Commissioners

2

September 22, 1997

Ms. Elaine M. Lehnert, Technical Manager
Accounting Standards, File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Lehnert,

Thank you for providing the NAIC an opportunity to review the AICPA Exposure Draft dated June 30, 1997 on the Proposed Statement of Position on Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk. The Property and Casualty Reinsurance Study Group and the Accounting Practices and Procedures (EX4) Task Force of the NAIC have given extensive consideration to this document.

While Paragraph 14 of the SOP permits changes in the recorded amount of the deposit on contracts that transfer only underwriting risk to be reflected in incurred losses in the underwriting account, and therefore to affect underwriting income, the NAIC's position is that only contracts that transfer both underwriting and timing risk may be given reinsurance accounting treatment. Contracts that fail to satisfy this requirement must be accounted for as deposits, and any changes in the amount of the deposit must be reflected in other income rather than in underwriting income.

Sincerely,

Vincent Laurenzano
Chair, Property and Casualty Reinsurance Study Group

W:\sept97\other\misc\aicpa letter

Arkansas Society of Certified Public Accountants
415 North McKinley Street • Suite 970 • Little Rock, Arkansas 72205-3022

3

MEMORANDUM

DATE: **September 23, 1997**

TO: **Elaine M. Lehnert, Technical Manager**
Accounting Standards, File 3162.DA
American Institute of CPAs
1211 Avenue of the Americas
New York, New York 10036-8775

FROM: **Barbara S. Angel, Executive Director**
Arkansas Society of CPAs

RE: **Exposure Draft – Proposed SOP – Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that do not Transfer Insurance Risk**

In response to your request for comments on the above Exposure Draft, the Arkansas Society of CPAs would like to suggest that on page 14, section 6, last paragraph, first sentence, that a footnote reference be added citing the authoritative guidance for determining when deposit accounting should be applied. We believe users of this statement would benefit from such a reference.

Thank you.

Barbara Angel
/bsa

Phone (501) 664-8739 • (800) 482-8739 in Arkansas • Fax (501) 664-8320
www.arcpa.org

4

EXPOSURE DRAFT

PROPOSED STATEMENT OF POSITION
Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk

September 25, 1997

Elaine M. Lehnert, Technical Manager
Accounting Standards, File 3162.DA
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Response Prepared by: Accounting and Auditing Standards Committee
Louisiana Society of CPA's

Albert E. Roevens, Jr.
William R. Hender
Joseph T. Green
Judson J. McCann, Jr.
Gerald A. Walker
Jon Flair
John D. Cameron

Response Submitted by: John D. Cameron, Member

General Comments:

The exposure draft was difficult to understand. It appears that the four types of contracts referred to in the draft have little to do with the traditional contracts that do reimburse for loss. The contracts discussed in the exposure draft appear to be investment or hedging type contracts. The exposure draft should include examples to include industry specific name of these contracts and include the situations in which an entity would purchase or sell this type of contract.

Comments on Issues Requested by Exposure Draft:

Issue 1: Although it may be difficult for a non-insurance enterprise to apply this SOP, we believe it should apply to all entities.

Issue 2: We believe more guidance is needed as discussed above.

Issue 3: The cumulative effect of a change in accounting principle would be appropriate.

Issue 4: The effective date appears reasonable.

Other Specific Comments:

Under Disclosures, Item No. 19(b) needs to be extended to include the amortization period.

TRANSATLANTIC HOLDINGS, INC.

(5)

9-29-97

September 26, 1997

Ms. Elaine M. Lehnert
Technical Manager, Accounting Standards
File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Position (Exposure Draft)

Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that do not Transfer Insurance Risk

Dear Ms. Lehnert:

We have reviewed subject exposure draft, concurring with its overall intent and generally with its approach to standardizing accounting practice for deposits. However, we take exception to the prescribed accounting for "insurance and reinsurance contracts that transfer only significant underwriting risk" by insurance enterprises (Paragraphs 13 through 15).

We believe that including the net profit or loss from such a contract as a positive or negative incurred loss on the Income Statement contradicts the notion included in previous literature on this topic (i.e. SFAS No. 113, Chapter 22 of the NAIC Accounting Practices Manual, EITF 93-6) that these transactions are not "insurance" or "reinsurance" as insufficient "insurance" risk transfer has occurred. The traditional insurance accounting model includes only insurance transactions in its premium and loss accounts. The inclusion of non-insurance related charges or credits disturbs the important matching of earned premiums and related losses and causes the use of such elements in the combined ratio to become misleading. As you know, the combined ratio serves as a critical measure of underwriting performance from insurance transactions.

Furthermore, we do not believe that the disclosure solution prescribed in the ED cures the presentation deficiencies described above since disclosure does not cure bad statement presentation. In addition, financial statement data often appears without footnote information that would be critical in understanding the reported results. Such data and related statistics will become misleading in our view and could easily be misused by financial analysts and other users of the financial statements.

We recommend that the residual profit or loss from insurance and reinsurance contracts that transfer only significant underwriting risk be included in a separate line within the operating income section of the Income Statement.

If there are any questions as regards the above, you may contact me at 212-770-2040.

Very truly yours,

S. Skalicky by sh

Steven S. Skalicky
Senior Vice President and Controller
Transatlantic Holdings, Inc.

KRAMER CONSULTING SERVICES, INC.
PORT CLINTON SQUARE • SUITE 200
600 CENTRAL AVE. • HIGHLAND PARK, IL 60035 • (847) 432-2250
FAX (847) 432-2573

(6)
9/29/97

September 29, 1997

Ms. Elaine M. Lehnert, Technical Manager
Accounting Standards, File 3162.DA
AICPA
1211 Avenue of the Americas
New York, New York 10036

Dear Ms. Lehnert:

I would like to comment on the proposed Statement of Position -- Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that do not Transfer Insurance Risk (SOP), dated June 30, 1997.

Issue 2
I agree that the SOP should provide guidance on accounting for all four kinds of contracts identified in the proposed SOP.

Issue 3
I agree with the proposed method of accounting for the transition as described in paragraph 20.

Issue 4
I agree with the proposed effective date.

Other comments
I believe that paragraph 8, which refers to the kinds of contracts to which the proposed SOP applies, should also refer to reinsurance contracts for which it is not reasonably possible that the reinsurer may realize a significant loss from the contract (as described in paragraph 9b of FAS #113).

Although I believe that the guidance provided in paragraph 13 is theoretically correct, I question whether it is appropriate to recognize reinsurance recoverable and unpaid losses on insurance and reinsurance contracts that transfer only significant underwriting risk at estimated present values when all other "long tail" reinsurance recoverable and unpaid losses are recognized at ultimate values. In spite of the reasoning put forth in paragraph 28, I believe that present value accounting for a relatively small portion of most insurance

⑥
9/29/97

entities' reinsurance recoverables and unpaid losses is not appropriate until all "long tail" reinsurance recoverable and unpaid losses are accounted for at present value.

As stated in paragraph 14, I do not believe that the reduction in the deposit related to the unexpired portion of the coverage provided should be recorded by insurance enterprises as an adjustment to incurred losses, but should be recorded as an adjustment to earned premiums, just like changes in unearned premiums.

With respect to paragraph 17, I believe that when sufficient information becomes available to reasonably estimate and allocate premiums, if it is then determinable that the insurance or reinsurance contract actually did transfer insurance risk, the contract should be accounted for as a risk transferring contract. Just because FAS #113 did not provide for subsequent reevaluation of a contract is not sufficient basis to require deposit accounting for a contract that actually transfers insurance risk. In other areas of accounting, it is not uncommon to change the method of accounting for a given transaction as more, and better, information becomes available.

I will be happy to discuss my comments and recommendations with you at any time.

Sincerely,

Loren Kramer

Loren B. Kramer

KCS

RAA
REINSURANCE ASSOCIATION OF AMERICA
1301 Pennsylvania Avenue, N.W. Suite 900, Washington, D.C. 20004-1701

Telephone: (202) 638-3690
Facsimile: (202) 638-0936

7 9-30-97

Via Federal Express

September 29, 1997

Ms. Elaine Lehnert, Technical Manager
Accounting Standards, File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Proposed Statement of Position

Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk

Ms. Lehnert:

On behalf of the Reinsurance Association of America, we are pleased to provide the AICPA with our comments on its exposure draft of the proposed Statement of Position (SOP), *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk.* As you know, the proposed SOP requires that insurance contracts that do not transfer both timing and underwriting risk and reinsurance contracts that fail to meet the requirements of SFAS No. 113 *(Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts)* be considered deposit contracts and classified as one of the following:

A. A contract that transfers only significant timing risk.

B. A deposit contract that transfers only significant underwriting risk.

C. A contract that transfers neither significant timing nor significant underwriting risk.

D. An insurance or reinsurance contract with an indeterminate risk.

While we agree with the accounting guidance in this SOP for Type A and Type C contracts above, we are concerned that accounting proposed for Type B deposit contracts conflicts with the spirit and intent of SFAS No. 113 and would hinder the comparability of financial statements. The proposed accounting would allow Type B deposit contracts to have a form of reinsurance accounting since, as proposed, such deposits would be recorded in the underwriting accounts, as discussed below.

7

For deposit contracts that transfer only underwriting risk, this SOP requires the deposit asset or liability to be measured based on the unexpired portion of the coverage provided until a loss is incurred that will be reimbursed under the contract. Once a loss is incurred, the deposit is initially recorded at the discounted value of the expected future cash flows plus the remaining unexpired portion of the original deposit. Subsequent valuation changes due to the passage of time and any adjustments to the amount to be recovered are recorded as an offset to incurred losses. Our principal concerns with the accounting guidance for Type B deposit contracts are as follows:

- ***Conflicts with SFAS No. 113:*** To obtain reinsurance accounting, SFAS No. 113 requires the reinsurer to assume both underwriting and timing risk. By allowing an offset to incurred losses for Type B deposit contracts, this SOP allows reinsurance accounting without the reinsurer assuming any timing risk at all. This proposed accounting circumvents the intent of SFAS No.113 to limit abuses that arise when (a) the timing of reinsurance recoveries is under a payment schedule or (b) payments are delayed or controlled. In such contracts, the recoveries do not vary with the timing of the claims settled by the ceding company (see SFAS No.113 paragraphs 8 and 62). The FASB was deliberate and explicit in prohibiting reinsurance accounting for contracts that delay timely reimbursement by the reinsurer. This guidance would effectively supersede the FASB's intent established in SFAS No. 113 (see also SFAS No. 113 Q&A #'s 20 and 21).

- ***Proposes quasi-hedging:*** Under the proposed SOP a new insurance accounting model is introduced that will contribute to confusion in interpreting insurers' financial statements. The insured would be allowed to reduce its incurred losses for both the change in the discounted value of the expected future cash flows and the amortization of the original deposit without a corresponding adjustment to premiums written. Insurers that utilize these kinds of deposit contracts would improve their loss ratios under this accounting method by offsetting these amounts to incurred losses without any reduction to their premiums written.

- ***Proposes watered-down market value accounting:*** The draft SOP does not require the Type B deposit asset to be marked to market each reporting period. Changes in interest rates will not affect the carrying value of this deposit asset or liability. As a result, this accounting model is an amalgam of the existing insurance model and a partial fair value approach.

- ***Creates potential abuses:*** The proposed accounting for Type B deposit contracts may be viewed by some insurers as more attractive than reinsurance accounting since net premiums are not reduced by the considerations and the SOP does not address retroactive accounting, creating a disconnect with SFAS No. 113. As a result, abuses may arise as some companies craft deposit contracts specifically to achieve Type B accounting.

7

- *Distorts comparability:* Type B deposit contracts were intended to be accounted for as deposit contracts under SFAS No. 113. While Type B deposit contracts are not materially different from Type A or Type C contracts, this proposed SOP makes a material distinction in the accounting that contributes to lack of comparability in this area. In addition, historical insurance underwriting performance matrices such as the loss ratio (incurred losses to premiums earned) and the ratio of net premiums written to gross premiums written will be distorted and not comparable to prior periods or other companies due to the inclusion of deposit contracts in the underwriting accounts.

- *Charges financing cost of deposit against losses:* This SOP would allow the changes in the discounted value of the future cash flows for Type B deposit contracts resulting from the passage of time, the interest-related component, to be offset to incurred losses. Since both Type A and Type C contracts offset the change in the deposit asset or liability to interest income or expense for the interest-related component, we don't agree with the distinction made for Type B deposit contracts which record the change in the underwriting accounts. AcSEC justified their decision by claiming the following: "because of the significance of the amounts recorded as incurred losses by these enterprises (insurance and reinsurance companies), AcSEC believes that disclosure of the components of the deposit that are recorded in incurred losses is appropriate." We view this as an attempt to hide these amounts in the financial statements and justify it by disclosing it in the notes to the financial statements.

- *Creates potential asymmetry between insurer and reinsurer:* If the accounting for deposit contracts of the insured and reinsurer are intended to be symmetrical, this SOP requires the reinsurer to discount the incurred losses for Type B deposit contracts at a different interest rate than the insurer. The discounting of a portion of loss reserves that may not be fixed and reliably determinable would create inconsistencies in the accounting of loss reserves so as to invite abuses and impair comparability. Currently, it is not accepted practice to discount insurance liabilities that are not fixed and reliably determinable.

Deposit accounting is an area that needed to be addressed to establish the appropriate accounting guidelines that would be applied consistently by all parties that utilize these kinds of deposit contracts. With the exception of the proposed accounting for deposit contracts that transfer only underwriting risk, we agree with the proposed accounting guidance provided in this SOP. We feel that if a contract does not pass both underwriting and timing risk, pursuant to SFAS No. 113, it is inappropriate to offset the change in the discounted value of the cash flows against incurred losses. These contracts should be accounted for in the same manner as contracts that transfer only significant timing risk and contracts that transfer neither significant timing nor underwriting risk, Type A and Type C contracts, respectively.

7

Finally, we strongly agree with the recent comment by Edmund L. Jenkins, FASB chairman, in his response to Alan Greenspan's comments on the hedge accounting exposure draft, which stated: "One of the FASB's fundamental principles is that disclosure in the notes to the financial statements is not a substitute for recognition in the financial statements." Accordingly, we urge the AICPA to classify deposit contracts as transactions that do not belong in insurance underwriting and not allow disclosure to compensate for mismatched recognition within the financial statements.

I have been asked to advise that American Re-Insurance Company and Zurich Reinsurance Centre, Inc. do not agree with these comments and believe that the SOP should be adopted in its current form.

Sincerely,

James M. Shamberger
Senior Vice President

JMS:prm

KPMG Peat Marwick LLP

1897·1997

55 East 52nd Street
New York, NY 10055

Telephone 212 909 5400

Fax 212 909 5699

8
9-30-97

September 25, 1997

Ms. Elaine Lehnert, Technical Manager
Accounting Standards, File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Lehnert:

Exposure Draft for Proposed Statement of Position: ***Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk***

We support the Accounting Standards Executive Committee's efforts to provide guidance on how to account for insurance and reinsurance contracts that do not transfer insurance risk. We support the issuance of a final Statement of Position (SOP) based upon the conclusions presented in the Exposure Draft.

We have the following comments:

Applicability and Scope - Paragraph 6 of the Exposure Draft states, "This SOP does not address or change existing requirements as to when deposit accounting should be applied." However, earlier in the same paragraph, the Exposure Draft states, "This SOP applies to all entities (emphasis added) that have entered into ... short-duration insurance and reinsurance contracts that do not transfer insurance risk as described in paragraph 44 of FASB Statement No. 5..." These two sentences can be interpreted to contradict one another because insurance enterprises do not evaluate the transfer of insurance risk for direct contracts as described in Statement No. 5.

Insurance enterprises account for insurance contracts that do not transfer insurance risk (for example, certain single-year retrospectively rated contracts and funding arrangements) as insurance contracts and not as deposits under the guidance of Statement of Financial Accounting Standards (SFAS) No. 60, *Accounting and Reporting By Insurance Enterprises*. SFAS No. 60, does not indicate the concepts of transfer of insurance risk should apply to an insurance enterprise's accounting for direct insurance contracts. (SFAS No. 60, however, provides insurance enterprises with an option to apply the deposit method if the ultimate premium cannot be reasonably estimated.)* Asymmetrical accounting results from this different guidance. An insured may account for a contract as a deposit, while an insurer would account for the same direct contract as insurance. EITF Issue 93-14, *Accounting for Multiple-Year Retrospectively Rated Insurance Contracts by Insurance Enterprises and Other Enterprises*, which only applies to multiple-year retrospectively rated contracts, is the only source of authoritative guidance that concludes that there should be symmetrical accounting between the insurer and the insured with respect to asset and liability recognition and the accounting for changes in coverage.

This SOP should clarify whether the guidance contained within this SOP would apply to an insurance enterprise's accounting for direct insurance contracts that do not transfer insurance risk.

Initial measurement - Paragraphs 9 and 24 of the Exposure Draft should be expanded to clarify the recognition treatment for premiums and fees to be retained by the insurer or reinsurer. We believe that such premiums and fees should be recognized on a pro-rata basis over the term of the contract.

Basis for Conclusions - Paragraph 27 of the Exposure Draft does not provide the rationale for using a current risk-free rate at the inception of the deposit and the lock-in concept. The calculation is, in essence, determining a "fair value" of the deposit, which will change at each reporting period. The risk-free rate will also be different at each reporting date. It would appear logical to consider changes in the risk-free rate along with changes in the anticipated cash flows.

Responses to the questions included in the Exposure Draft's transmittal letter follow.

1. *The proposed SOP would apply to all enterprises, including insurance enterprises and other enterprises. Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not?*

All enterprises should be subject to this SOP. Transactions of the same substance should be accounted for in a similar manner regardless of the type of enterprise consummating the transaction. We believe that enterprises will have sufficient information or data to enable them to apply the provisions of this proposed SOP. Such information is already widely available and used by enterprises when evaluating whether or not to enter into the contracts.

2. *This proposed SOP identifies four kinds of contracts and provides guidance on accounting for these kinds of deposit categories. Is there a need for guidance for all four kinds of contracts identified in the proposed SOP?*

We agree with the guidance contained in the Exposure Draft.

3. *This proposed SOP would require adoption at the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior periods should be restated). The effect of initially adopting this proposed SOP should be reported as a cumulative effect of a change in accounting principle (in accordance with the provisions of APB Opinion 20). Would another method of transition be more appropriate?*

We agree with the guidance contained in the Exposure Draft.

4. *This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1998, with earlier adoption permitted. Is the effective date appropriate?*

We believe that the effective date is appropriate. However, we encourage issuance of the final SOP as soon as possible to help avoid the inconvenience of having to restate any prior interim periods if an enterprise elects to adopt the SOP prior to its effective date.

We note the following editorial comments:

Paragraph 8, footnote 3 - uses the same words to define the terms in the text. The footnote should be reworded. We suggest the following wording: "With respect to insurance contracts, the timing of the loss reimbursement under the contract would be based on the timing of the payment with respect to the loss event. For reinsurance contracts, the timing of the loss reimbursement under the contract would be based on the timing of the payment by the insurer (reinsured) of the underlying loss, as well as when recovery is expected from the reinsurer."

Paragraph 8 - Items c. and d. should be aligned with b. as opposed to being presented as indentations under item b.

Paragraph 12, third line - "at that time" should be deleted.

Paragraph 12, fourth line - the "s" on "includes" should be deleted.

Paragraph 14, seventh line - "disclosure" should be changed to "disclose."

Paragraph 18 - the wording should be clarified to indicate that deposit assets and liabilities should be reported on a gross basis, unless the right of offset exists.

Paragraph 19 b. - the wording "These amounts..." in the last sentence should be clarified to indicate whether the amounts to be disclosed separately pertain to the aggregate adjustment to the deposit, or the individual components of the adjustment (i.e. separate disclosure of the interest accrual, the present value of the additional expected recoveries, and the present value of a reduction in expected recoveries).

Paragraph 31 - a footnote should be added to the table to indicate that the table only presents the recovery under the contract, and does not depict the underlying loss associated with the contract.

Very truly yours,

KPMG Peat Marwick LLP

KPMG Peat Marwick LLP

Coopers
&Lybrand

Coopers & Lybrand L.L.P.

a professional services firm

101 Hudson Street
Jersey City, New Jersey
07302

telephone (201) 521-3000

facsimile (201) 521-3333

9/30/97 9

September 30, 1997

Ms. Elaine M. Lehnert
Technical Manager, Accounting Standards
File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Subject: Proposed Statement of Position, *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk*

Dear Ms. Lehnert:

Coopers & Lybrand L.L.P. is pleased to submit our comments on the exposure draft of the proposed Statement of Position (SOP), *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk.* The Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AcSEC) is to be commended for its efforts to provide guidance on deposit accounting.

Overall, we are in agreement with the proposed SOP, except for the proposed accounting for contracts that transfer only significant underwriting risk. The comments that follow highlight our specific recommendations for clarifying the document.

Scope

Issue 1: The proposed SOP would apply to all enterprises, including insurance enterprises and other enterprises. Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not?

We are not aware of any reason to exclude non-insurance enterprises from the scope of this proposed SOP. We believe that such enterprises will generally have access to the requisite information.

(9)

In accordance with paragraph 18 of Statement 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113), "[t]o the extent that a reinsurance contract does not, despite its form, provide for indemnification of the ceding enterprise by the reinsurer against loss or liability, the premium paid less the premium to be retained by the reinsurer shall be accounted for as a deposit by the ceding enterprise." Paragraph 9 of FAS 113 indicates that "[i]ndemnification of the ceding enterprise against loss or liability relating to insurance risk in reinsurance of short-duration contracts requires *both* of the following, unless the condition in paragraph 11 is met:

a. The reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance contracts.
b. It is reasonably possible that the reinsurer may realize a significant loss from the transaction." [emphasis added]

Consistent with paragraph 9(a) of FAS 113, the proposed SOP provides for deposit accounting when a contract fails to transfer significant insurance risk (both timing and underwriting risk). However, the proposed SOP does not deal with contracts that fail to meet the condition set in FAS 113, paragraph 9(b). Consequently, it does not appear to cover all situations where deposit accounting is required. For example, if a contract were deemed to transfer insurance risk, but it was unlikely that the reinsurer would realize a significant loss, presumably deposit accounting would be required; and yet the proposed SOP does not provide any guidance on this matter. We think that, if AcSEC believes that the condition stipulated in paragraph 9(b) follows, by default, the condition stipulated in paragraph 9(a) (that is, a contract could never meet 9(a) condition and fail the 9(b) condition), a comment to that effect is warranted. Alternatively, we suggest that the SOP be broadened to address those contracts that fail the condition in paragraph 9(b).

Paragraph 6(b) notes that the scope of the proposed SOP includes long-duration contracts of "nonlife insurers." We believe that the emphasis should be on the type of contract rather than on the type of entity, which would be similar to the approach used in Statement 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, where no distinction is made between life/nonlife entities; rather, in Statement 97, certain types of contracts are excluded from its scope (e.g., those covered by Statement 60).

A further analysis the SOP's applicability and scope suggests that significant efforts are being made to focus on deposit accounting for short-duration contracts (i.e., nonlife entities) and to exclude applicability to life reinsurance. Based on the scope of the SOP, long-duration life/health insurance contracts that may be reinsured with short-duration contracts that do not pass risk transfer would not be addressed.

(9)

Kinds of Contracts

Issue 2: This proposed SOP identifies four kinds of contracts and provides guidance on accounting for these kinds of deposit categories. Is there a need for guidance for all four kinds of contracts identified in the proposed SOP?

Yes. Providing guidance for only some of these types of contracts may result in diversity of practice.

Initial Measurement

Paragraph 9 does not address the situation in which consideration paid or received is not fixed and determinable at the contract's inception. We assume that, in such cases, an estimate would need to be made and subsequently adjusted as additional information became available. Perhaps a clarifying statement to this effect would be helpful. Also, the use of the terminology "explicitly identified premiums or fees" in paragraph 9 may lead to contracts that state an "explicit" amount in order to arrive at a desired accounting treatment.

Subsequent Measurement

Paragraph 8(b) describes insurance or reinsurance contracts that transfer only significant underwriting risk. Paragraphs 13 through 15 provide guidance on the deposit method of accounting for such contracts, and the basis for conclusion is discussed in paragraph 30. It concerns us that, under such guidance, incurred losses could be significantly impacted by financing costs. Further, contracts could be structured whereby the financing element completely offsets losses such that a significant loss will not be incurred by the reinsurer. This treatment would appear to be contrary to the spirit of FAS 113. In addition, the proposed accounting does not allow for any offsetting benefit to premiums and thereby, further distorts an insurance company's loss ratio. At a minimum, we believe that the underwriting and interest-related elements of these contracts should be separately classified in the income statement, unless there is no reasonable possibility of significant loss to the insurer; in which case, the entire transaction should be accounted for as a financing.

We agree with the catch-up adjustment approach discussed in paragraphs 10 and 11. We point out, however, that it is inconsistent with the approach that is currently being considered for yield adjustments in the proposal on *Accounting for Discounts Related to Credit Quality*.

Paragraph 12 discusses a situation in which a contract was originally categorized as one that transferred only significant timing risk, or, transferred neither significant timing nor underwriting risk; at some point after initial measurement, the contact was determined to be carrying significant underwriting risk. This proposed SOP then points to paragraphs 13 through 15 for guidance on contracts that transfer only significant underwriting risks. The SOP does not address the possibility of a contract that (1) was originally categorized as transferring only significant timing risk and (2) was later determined to also transfer significant underwriting risk (i.e., that it subsequently qualifies for reinsurance accounting under FAS 113). We suggest that guidance be provided for transition accounting (i.e., retroactive, cumulative effect, or prospective accounting) in these circumstances.

Paragraph 13 notes that the initial deposit for contracts that transfer only significant underwriting risk is measured based on the unexpired portion of the coverage period. It is unclear whether this excludes the amount to be retained by the insurer/reinsurer (paragraph 9). Clarification to this effect would be helpful.

Paragraph 14 notes that the reduction in the deposit related to the unexpired potion of the coverage (i.e., amortization of the premium) is recorded as (1) an incurred loss for insurance companies (2) as an "expense" for non-insurance companies. Both insurance and non-insurance companies are required to record other changes in the deposit (i.e., recoveries) as an offset against the loss recorded that will be reimbursed under the insurance or reinsurance contract. The "expense" terminology may be viewed as allowing non-insurance companies to record amortization separately from the loss. To avoid confusion, we suggest replacing the term "expense" with "other operating expenses," as compared to "incurred losses" for insurance companies.

Currently, there is an inconsistency in the interest rates prescribed in various pronouncements and proposals related to discounting. FAS 113 prescribes an interest rate in paragraph 66 that is "reasonable and appropriate," while the proposed SOP proposes an interest rate in paragraph 15 that should be based on "the current rate on United States government obligations with similar durations, adjusted for default risk under the existing contract" (if a deposit asset).

The last sentence of paragraph 15 indicates that a discount rate should be established at the date each loss is incurred and should be used for the remaining life of the contract. Paragraph 27 (which explains AcSEC conclusions for arriving at the discount rate [described in paragraph 15] and the need to use different rates for different losses) is contrary to the guidance in paragraph 66 of FAS 113 that "a constant interest rate is used in determining those present values because the possibility of investment income varying from expectations is not an element of insurance risk." Additionally, we believe that the proposed method is unduly complicated and is inconsistent with a fair value approach, if that is that AcSEC is trying to accomplish.

Transition

Issue 3: This proposed SOP would require adoption at the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). The effect of initially adopting this proposed SOP should be reported as a cumulative effect of a change in accounting principle (in accordance with the provisions of APB Opinion 20). Would another method of transition be more appropriate?

No. We agree with the transition requirements as proposed in paragraph 20.

9

Effective Date

Issue 4: This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1998, with earlier adoption permitted. Is the effective date appropriate?

Yes. We do not believe that the proposed effective date will present any undue hardship, as most enterprises are already accounting for these types of transactions and have the necessary data to conform.

Other Comments

Paragraph 36 notes that "there are no provisions in FASB Statement No. 113 that provide for subsequent reevaluation of a contract." However, the FASB *Viewpoints* article clearly states that a reevaluation should be made whenever an amendment occurs (Q11) and allows a reclassification in other situations (Q14), which would appear to contradict this statement.

Paragraph 37 makes reference to symmetrical accounting. If it is AcSEC's intent that the accounting by the insured and the insurer be symmetrical, we suggest that this concept be addressed in the body of the SOP. We recommend that it be incorporated into paragraph 9, "Initial Measurement."

The illustration in paragraph 46 seems to address conversions of contracts that do not transfer timing or underwriting risk, as well as conversions of contracts that transfer only timing risk. As such, the heading to that paragraph should reflect both situations.

* * * * * *

We appreciate the opportunity to express our views. If you have any questions regarding our comments, please contact James F. Harrington (201-521-3039) or Brett E. Cohen (201-521-3065).

Very truly yours,

Coopers & Lybrand L.L.P.

NORTHEAST INVESTORS GROWTH FUND

Fifty Congress Street • Boston • Massachusetts 02109-4096

617-523-3588 (FAX) 617-523-5412

9-30-97

10

William A. Oates, Jr.
PRESIDENT

September 25, 1997

Ms. Elaine Lehnert, Technical Manager
Accounting Standards, File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Lehnert:

I am the president of Northeast Investors Growth Fund, a mutual fund based in Boston. Among the investments in this fund are several insurance companies, and therefore, I have an interest in the usefulness of insurers' financial statements. Accordingly, I would like you to consider some reactions to the draft Statement of Position, *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk*. Some of these comments are based on discussions with industry representatives.

Prior to the issuance of FASB Statement No. 113, the accounting applied by insurers for reinsurance transactions was inconsistent. There was some concern that certain insurers, particularly those under great financial pressure, entered into financing transactions that, in form, were "finite" reinsurance with the intended result of delayed recognition of their financial problems. These financing transactions obscured the financial statements of such companies.

FASB No. 113 eliminated much of the flexibility and lack of comparability that had previously existed when it provided clear guidance that prohibited insurance companies from treating deposit or financing transactions as reinsurance. By eliminating these accounting inconsistencies, the quality and consistency of information contained in the financial statements of insurance companies significantly improved.

Unfortunately, the AICPA's draft SOP reverts more towards financial statement flexibility, lack of comparability and confusion. As drafted, the SOP makes relatively minor distinction in types of deposit contracts, but allows for major distinctions in the resulting accounting.

While a deposit contract fundamentally is a financing transaction, the AICPA's draft would *de facto* overrule FASB No. 113 by allowing the "Type B" contracts to be treated as insurance underwriting activity. The effectiveness of FASB No. 113 lay in its distinction between reinsurance (risk transfer) and deposit transactions (no risk transfer).

10

FASB No. 113 would be made toothless if contracts that fail risk transfer under FASB No. 113 are allowed to be accounted for in a manner substantially similar to those that meet risk transfer. As a user of financial statements, I would expect that we have lost ground with this proposed SOP.

In summary, I am concerned that this proposed SOP would impair the usefulness of insurers' financial statements. I would recommend that the AICPA redraft the guidance for Type B deposit contracts to conform more with Type A contracts and, therefore, more with the intent of FASB No. 113. Deposit contracts should not contaminate insurers' underwriting results and key ratios that are the basis for investor analysis. Finally, disclosure is not an adequate means to correct flawed recognition within the income statement.

Sincerely,

William A. Oates, Jr.

William A. Oates, Jr.

9/30/97 (11)

CNA

CNA Plaza Chicago IL 60685-0001

Patricia L. Kubera
Group Vice President
and Controller

Telephone 312-822-6271
Facsimile 312-822-2893

September 30, 1997

Ms. Elaine M. Lehnert
Technical Manager, Accounting Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Position, "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that Do Not Transfer Insurance Risk" (File 3162.DA)

Dear Ms. Lehnert:

We are pleased to offer comments on the proposed Statement of Position, "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that Do Not Transfer Insurance Risk" ("SOP"). In addition to providing specific responses to the issues specified in the proposed SOP, we offer our overall support for this proposed SOP.

We acknowledge the fact that previously issued pronouncements have called for the application of deposit accounting but did not provide guidance on what that application involves. As a result, we have limited our review to the theoretical aspects of the document's application guidance. In addition, we support the need for this document to provide specific accounting guidance on what procedures to apply to the particular risk, or no risk, being transferred in an insurance or reinsurance contract.

We are concerned, however, that the implementation of the SOP may be cumbersome and costly, considering the use of applying the interest method for calculating the amount of deposit asset or liability during the life of a contract that transfers only timing risk.

Our specific responses to the issues requested in the proposed SOP can be found in Attachment A of this letter.

We appreciates the opportunity to comment on this proposal. If you would like to discuss these comments further, please do not hesitate to call.

Sincerely,

Patricia Kubera

Patricia Kubera

A 1897 1997 Century of Commitment

11

ATTACHMENT A

Issue 1: The proposed SOP would apply to all enterprises, including insurance enterprises and other enterprises. Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not?

No, there does not appear to be any reason to exclude non-insurance enterprises from the scope of the SOP, if indeed they are parties to an insurance or reinsurance contract that does not transfer insurance risk.

Yes, we believe that non-insurance companies may obtain the necessary information to apply the SOP from the insurance or reinsurance contracts themselves, and well as resulting cash flow activity occurring during the life of the contract.

Issue 2: This proposed SOP identifies four kinds of contracts and provides guidance on accounting for these kinds of deposit categories. Is there a need for guidance for all four kinds of contracts identified in the proposed SOP?

Yes.

Issue 3: This proposed SOP would require adoption at the beginning of the entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). The effect of initially adopting this proposed SOP should be reported as a cumulative effect of a change in accounting principle (in accordance with the provisions of APB Opinion 20). Would another method of transition be more appropriate?

No.

Issue 4: This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1998, with earlier adoption permitted. Is the effective date appropriate?

Yes. The effective date allows reasonable time for analysis of existing contracts and implementation in regards to those contracts.

(12) 9/30/97

ROBINSON,
GRIMES &
COMPANY, P.C. CERTIFIED PUBLIC ACCOUNTANTS

MEMBERS
• SEC and Private Companies Practice Sections of the American Institute of C.P.A.s
• Georgia Society of C.P.A.s

September 30, 1997

Ms. Elaine Lehnert, Technical Manager
Accounting Standards
File 3162.DA, AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

VIA FAX

Re: Exposure Draft
Proposed Statement of Position
Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk

Dear Ms. Lehnert:

The Georgia Society of Certified Public Accountant's Accounting and Auditing Committee is pleased to submit its response to the exposure draft on Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk

Our response follows:

Scope

Issue 1: We feel consideration should be given to exempting "small" non-insurance enterprises from this standard. Small enterprises will have a difficult time in gathering and understanding this information.

Kinds of Contracts

Issue 2: We feel guidance is needed for all four kinds of contracts identified in the proposed SOP. We also believe there is a need to better explain in what types of situations these contracts are being used from the insured's perspective. We realize this SOP does not address or change existing requirements as to when deposit accounting should be applied, but we feel that more detailed examples in Paragraphs 37 – 46 would be beneficial to the users. For example, in paragraph 38 AcSEC may want to consider giving a specific example of when a contract does not transfer Timing nor significant Underwriting risk. Also in the same example maybe include how one might estimate the expected recoveries.

5637 Whitesville Rd./P.O. Box 4299/Columbus, Georgia 31904/706 324-5435/FAX 706 324-1209

(12) 9/30/97

We appreciate the opportunity to offer this response. If you have any questions regarding this response, please feel free to contact Brian Rutledge at (706) 324-5435.

Sincerely,

Accounting and Auditing Committee

Brian Rutledge

By: Brian B. Rutledge, Committee Member

AMERICAN INSURANCE ASSOCIATION
LAW DEPARTMENT

1130 Connecticut Avenue N.W.
Suite 1000
Washington, D.C. 20036
(202) 828-7100
(202) 293-1219 FAX

September 30, 1997

9/30/97 13

FAX (212) 596-6213
Ms. Elaine M. Lehnert
Technical Manager
Accounting Standards
File 3162.DA
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

RE: PROPOSED STATEMENT OF POSITION, DEPOSIT ACCOUNTING: ACCOUNTING FOR INSURANCE AND REINSURANCE CONTRACTS THAT DO NOT TRANSFER INSURANCE RISK

Dear Ms. Lehnert:

American Insurance Association (AIA) is a trade association of more than 300 property-casualty insurance companies. Our members issue insurance policies directly to the public in the United States and throughout the rest of the world. In addition, many of our members both assume and cede reinsurance. The purposes of AIA are to provide a forum for discussion of problems which are of common concern to its members and the public; to keep members informed of regulatory, legislative and judicial developments and to serve the public interest through appropriate activities such as submitting these comments.

The AIA Committee on Financial Management Issues developed comments to the June 30, 1997 Exposure Draft (ED), with respect to property-casualty insurance, for Issues 1 and 2:

ISSUE 1: SHOULD THE SOP APPLY TO ALL ENTERPRISES?

The SOP should apply to all enterprises. Paragraph 44 of FASB Statement No. 5, *Accounting for Contingencies,* indicates, in pertinent part, "To the extent that an insurance contract . . . does not, despite its form, provide for indemnification of the insured . . . by the insurer . . . against loss or liability, the premium paid less the amount of the premium to be retained by the insurer . . . shall be accounted for as a deposit by

(13)

the insured . . . ." (Emphasis added.) Thus, FASB Statement No 5 requires that insureds (as well as insurers and reinsurers) account for certain insurance contracts as deposits.

In addition, recent developments in financial services modernization include financial institutions other than insurance companies engaging in traditional insurance transactions. These developments highlight the importance of all enterprises applying the same method of accounting for deposit transactions.

ISSUE 2: IS THERE A NEED FOR GUIDANCE FOR ALL FOUR KINDS OF CONTRACTS IDENTIFIED IN THE SOP?

This SOP should provide guidance on how to apply the deposit method of accounting when it is required for insurance and reinsurance contracts that do not transfer insurance risk. There is no need for the SOP to address when deposit accounting should be applied because those criteria are already addressed in existing requirements.

We believe that the explanatory material within the categories in paragraph 8 of the ED provides guidelines for making an accounting decision. Paragraph 8a, for example, indicates that an insurance (or reinsurance) contract that limits the amount of underwriting risk to which the insurer (or reinsurer) is subject may result in an insufficient transfer of insurance risk. As a further guideline, paragraph 8a suggests that insurance (or reinsurance) contracts that provide for experience adjustments may indicate that a sufficient amount of underwriting risk has not been transferred.

Paragraphs 8b and 8d also include examples and features of insurance or reinsurance contracts that meet the characteristics of deposits arrangements. We believe that these guidelines provide criteria for determining when deposit accounting is appropriate and should be deleted.

CONCLUSION

AIA believes that the SOP should apply to all enterprises. We also agree that the SOP should not provides criteria and guidelines to evaluate whether an insurance contact transfers insurance risk and should be amended to delete references to examples and features of insurance contracts that constitute such criteria.

13

Thank you for this opportunity to provide comments. We would be pleased to answer any questions that you may have.

Sincerely,

Phillip Schwartz

Phillip Schwartz
Vice President
Financial Reporting &
Associate General Counsel

Travelers Life & Annuity
A Member of TravelersGroup

Travelers Property Casualty
A Member of TravelersGroup

(14)

10/1/97

One Tower Square – 4PB
Hartford, CT 06183-1073
860 277-7499
FAX: 860 954-3708
pauline_c_panik@travelers.com

Paula C. Panik
Vice President
Accounting Policy
Finance

September 30, 1997

Ms. Elaine M. Lehnert
Technical Manager, Accounting Standards
American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036-8775

RE: File 3162.DA

Dear Ms. Lehnert:

Travelers appreciates the opportunity to comment on the exposure draft (ED) of the proposed Statement of Position (SOP), *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk* which was released by the Accounting Standards Executive Committee of the AICPA for public comment.

With respect to the issues raised in the cover letter to the ED, we offer the following comments:

Issue 1: This SOP should apply to all enterprises entering into the types of contracts described in paragraph 8 of the SOP. It is not appropriate to exclude non-insurance enterprises from the scope of the SOP. Non-insurance enterprises can and do enter into the types of contracts described in paragraph 8 and have the same information as an insurance enterprise entering into such contracts, as well as the ability to obtain internal and/or external advice in evaluating those contracts.

Issue 2: The Deposit Accounting Task Force should consider the question of whether there is a need to distinguish among different types of deposit contracts. Some issues to consider are: Are the distinctions contained in the current ED based upon a meaningful difference in the manner in which earnings occur from deposit contracts? If the distinctions are meaningful, are the results of applying the various deposit accounting approaches significant enough to warrant the complexity of having several different types of deposit accounting? Is the reader of the financial statements better served by keeping the accounting for deposits simple?

14

If there is to be a distinction in the types of deposit contracts and the resulting accounting is to be based upon that distinction, it is appropriate to provide accounting guidance for each type of contract.

Issue 3: The effect of initially adopting this proposed SOP should be reported as a cumulative effect of a change in accounting principle. However, there needs to be some discussion of how the transition of this SOP interacts with the transition guidance contained in paragraph 33 of Statement of Financial Accounting Standards No. 113 (FAS 113), *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*. (Paragraph 33 provides: The provisions of this Statement that establish the conditions for reinsurance accounting and address recognition of revenues and costs apply to reinsurance contracts entered into, renewed, amended, or having an anniversary date in the year of adoption.) As a result of the transition guidance in FAS 113, there are certain contracts which were exempted from the risk transfer criteria contained in FAS 113 and, accordingly, the guidance contained in this SOP should not be applied to such contracts.

Issue 4: Given the planned completion date of the SOP, the proposed effective date is appropriate.

General Concerns

In general, we believe there is a need for accounting guidance for contracts that are deemed to be deposits, as such guidance does not currently exist. However, we are not certain if there is a need to have several different types of deposit accounting approaches (one of which the change in the amount of deposit reported on the balance sheet would be reported as part of underwriting results). By introducing complexity through the use of multiple deposit accounting methods, the risk of providing information that is not meaningful to readers of the financial statements increases significantly. An accounting standard that does not offer the benefits of providing additional useful information to the reader is of questionable value.

By using the risk transfer criteria from FAS 113 as its basis, the draft SOP contains four different types of deposit accounting. A simpler approach would be to have one accounting model for deposits which recognizes deposit earnings accumulation separately from the application of deposit funds. This approach would be identical to the example provided in paragraph 40 of a contract that transfers only significant timing risk. Under this approach, the reporting enterprise would need only to determine if a contract is to be accounted for as reinsurance, insurance (see discussion below concerning insurance contracts), or a deposit.

Insurance Contracts

Paragraph 6 states that this SOP does not address or change existing requirements as to when deposit accounting should be applied to insurance or reinsurance contracts. However, by using the risk transfer criteria from FAS 113 as the criteria for distinguishing

14

among the types of deposit contracts (i.e., contracts which contain significant timing risk, underwriting risk, neither timing nor underwriting, or indeterminate risk), the SOP suggests that the FAS 113 risk criteria are also the basis for evaluating insurance contracts. Unlike FAS 113, however, Statement of Financial Accounting Standards No. 5 (FAS 5), *Accounting for Contingencies* and FASB Emerging Issues Task Force (EITF) No. 93-14, *Accounting for Multiple-Year Retrospectively Rated Insurance Contracts by Insurance Enterprises and Other Enterprises* do not distinguish between underwriting and timing risk for insurance contracts, but instead state that the determination of whether an insurance contract is to be accounted for as insurance (or as a deposit) is based upon whether the contract provides for indemnification of the insured.

With the adoption of FAS 113, paragraph 44 of FAS 5 was amended to require that reinsurance contracts meet the risk transfer criteria contained in FAS 113 to be accounted for as reinsurance. No changes, however, were made to FAS 5 with respect to *insurance* contracts.

Until such time as further guidance is developed for evaluating insurance contracts, we recommend deletion from the SOP of all references to FAS 113 risk criteria when used in the context of insurance contracts. Instead, the SOP should refer the reader back to the appropriate guidance depending upon the nature of the contract, e.g., FAS 5 and EITF 93-14 for insurance contracts and FAS 113 for reinsurance contracts. Examples of the types of references that should be removed can be found in the fourth sentences of paragraphs 8a and 8b.

Specific Comments

In addition to the above general comments, we have also provided specific comments by paragraph number which can be found in the attachment to this letter.

* * * * *

We would like to thank AcSEC for the opportunity to comment on this ED. Although we are in agreement as to the need for guidance on deposit accounting, we are concerned that the approach taken in the SOP may be overly complex without providing the reader of the financial statements with meaningful information .

We would welcome an opportunity to review these comments with you or answer any questions that you may have. Please feel free to call me.

Sincerely,

Paula C. Panik

Paula C. Panik

14

COMMENTS

Proposed Statement of Position - ***Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that Do Not Transfer Insurance Risk***

Paragraph Number	Comments
12	This paragraph provides that if there are significant changes in the total amount of actual and estimated cash flows, the enterprise should determine whether the accounting for the contract should be changed to be consistent with contracts having underwriting risk only. FAS 113 generally does not allow reclassification of a contract subsequent to the contract inception unless it is necessary to recognize a correction of an error. (see the response to question 14 contained in the FASB Viewpoint Q&A's to FAS 113).
17	This paragraph does not state what is to be done if a contract with indeterminate risk is subsequently determined to have both timing and underwriting risk. Should the accounting for such contracts be bifurcated and accounted for both ways or reclassified as an insurance or reinsurance contract?
19b	This paragraph requires that additional expected recoveries and reductions in expected recoveries be disclosed separately. Is there a rationale for not disclosing such amounts net?
27	This paragraph requires the use of a risk-free rate for contracts that transfer only significant underwriting risk. Due to the nature of such contracts, it does not appear appropriate to use a risk-free rate as the contracts involve significant amount risk (i.e., underwriting risk). By using the risk-free rate, the underwriting or amount risk in the deposit is ignored. This paragraph also requires the use of a different discount rate for each loss under the contract and where there is more than one loss, to use different rates for each of the loss occurrences. In most contracts large enough to warrant a deposit, the coverage usually entails multiple claims and it would not be practicable to use a different rate for each loss. A more practical approach would be to apply one rate (or schedule of rates) to the aggregate analysis instead of applying a separate discount rate to each claim.

10/1/97 (15)

AMERICAN ACADEMY *of* ACTUARIES

September 29, 1997

Ms. Elaine M. Lehnert
Accounting Standards, File 3162.DA
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Lehnert:

The American Academy of Actuaries Committee on Property and Liability Financial Reporting (COPLFR) has the following comments on the SOP exposure draft - "Deposit Accounting: Accounting For Insurance And Reinsurance Contracts That Do Not Transfer Insurance Risk".

1. Paragraph 11 - **subsequent measurement when cash flow assumptions change.** This paragraph requires that a retrospective approach be used if the cash flow assumptions change for a contract with only timing risk. In other words, a new effective interest rate is to be calculated using the new projected flow and the initial deposit. The current deposit value is then based on this new interest rate and the new projected flow, with future amortization of interest based on this new interest rate. This requirement to use a retrospective method contradicts paragraph 62 in FASB's exposure draft (no. 174-B) titled "Proposed Statement of Financial Accounting Concepts - Using Cash Flow Information in Accounting Measurements".

   The use of the retrospective method (as proposed in paragraph 11) would cause the impact of any new information (or estimate) to be amortized over the entire length of the cash flow. The reason for this is as follows:

   - The initial value for the deposit must be assumed to be at a fair or market value.
   - This fair value, by definition, would reflect market interest rates at the time.
   - By fixing the value of the initial deposit, and recalculating the interest rate given the new estimated flows, the retrospective method will produce a new interest rate.
   - Assuming that market rates have not changed significantly since the contract inception (as has been the case in the United States, recently, with relatively stable interest rates), the new deposit value will be valued using an interest rate not equal to the market rate.

- By not using an interest rate based on or close to the market rate, the resulting deposit will not approximate a fair or market value.

- The only time the deposit will equal the fair or market value is when it is reduced to zero, when the liability is extinguished. Therefore the deposit under the retrospective method will not be set at fair or market value, but will gradually converge to it during the life of the cash flows.

This is in contrast to FASB's approach, whereby any impact in re-estimation of the flows is reflected immediately in the year of the re-estimating, assuming that rates haven't changed significantly since the original contract inception. To use an approach that deviates from fair values or their surrogates seems to run counter to FASB's desire to move towards fair value balance sheet.

FASB's proposed approach is much less likely to distort future earnings, as it would amortize the deposit discount using a rate that at least initially approximated a market rate. The only way it could be closer would be if they required a fresh start measurement using market rates. The SOP's approach instead would distort future earnings, and cause the balance sheet to deviate instead would distort future earnings, and cause the balance sheet to deviate from fair values. As a result, we recommend that the SOP be changed to be consistent with the FASB proposal.

2. Paragraphs 10, 12, 14, 17 - **The possibility that the amortization of the deposit discount will change its location in the income statement**.
   These paragraphs say that the accrual of cash flow discount is reflected in interest expense if only timing risk exists (paragraph 10), and its reflected in losses incurred if only underwriting risk exists. Paragraphs 12 and 17 say that if the other kind of risk is found to exist instead, then the accounting for the discount should flip-flop, from interest expense to losses incurred, or from losses incurred to interest expense. This might cause confusion and distort the financials. Therefore, it may be better if all accruals stayed in one place.

3. Paragraph 12 - **Contracts with only timing risk that face significant changes in expected flows.**
   This paragraph says that if a significant change in the expected cash flows occurs which implies that significant underwriting risk does exist, then the contract should still be accounted for under deposit accounting. It is likely that a contract thought to have timing risk for which underwriting risk is "discovered" would probably now have both, i.e. would qualify as having true "transfer of risk" for insurance purposes. Is it the intent to continue using deposit accounting for these contracts?

4. Paragraph 17 - Is it possible for a contract with indeterminate risk to end up having both underwriting and timing risk? In this case, should the SOP allow for subsequent use of insurance accounting for the contract?

5. Paragraph 43 - **reflection of risk in discounting the flows.**
   This example says to discount the expected flow at a risk-free rate, with no reflection of risk except for default risk (i.e. the insurer not paying the insured). No mention is made of amount risk. This contradicts the FASB exposure draft (No. 174-B) issued June 11, 1997, and paragraph 19 of this FASB document in particular, which require that the discounted value reflect all risks present in the flows. The AICPA's example may need to be changed to make it consistent with the FASB exposure draft.

Thank you for the opportunity to comment on this SOP exposure draft. If you have any questions or would like to discuss our comments, you may contact me through Steve Rentner at 202-785-7875.

Sincerely,

Jan A. Lommele

Jan A. Lommele, FCAS, MAAA, FCA
Chairperson
Committee on Property and Liability Financial Reporting

cc: COPLFR Members
Michael L. Toothman
Steve Rentner

0107g/JAL

9/30/97 (16)

INSTITUTE of MANAGEMENT ACCOUNTANTS
CERTIFIED MANAGEMENT ACCOUNTANT PROGRAM
CERTIFIED IN FINANCIAL MANAGEMENT PROGRAM

September 30, 1997

Ms. Elizabeth A. Fender, CPA
Director, Accounting Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Position, "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that Do Not Transfer Insurance Risk" (File 3162.DA)

Dear Ms. Fender:

The Financial Reporting Committee ("FRC") of the Institute of Management Accountants is pleased to offer comments on the proposed Statement of Position, "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that Do Not Transfer Insurance Risk" ("SOP").

Overall we support the issuance of this document. While existing pronouncements call for the use of deposit accounting, there is little guidance on how to apply deposit accounting to specific transactions. This proposed SOP adequately provides accounting guidance application.

We do question the statement made in paragraph 8(a), which offers the example that insurance and reinsurance contracts which provide for experience adjustments may indicate that a sufficient amount of underwriting risk has not been transferred. We believe that this statement requires further explanation, perhaps footnoted, as to why experience adjustments would indicate lack of underwriting risk being transferred. As is, the statement is ambiguous and may lead to an automatic assumption that experience adjustments always indicate insufficient transfer of underwriting risk.

We have provided specific responses to the issues requested in the proposed SOP, which are found in Attachment A.

The FRC appreciates the opportunity to comment on this proposal. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

L. Hal Rogero/tf

L. Hal Rogero, Jr.
Chair

Financial Reporting Committee

10 Paragon Drive • Montvale, New Jersey 07645-1760
(800) 638-4427, Ext. 215 • Fax (201) 573-0639

16

Attachment A

Issue 1: The proposed SOP would apply to all enterprises, including insurance enterprises and other enterprises. Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not?

If companies, whether insurance or non-insurance, are parties to insurance contracts that do not transfer insurance risk, then they should be included in the scope of this SOP. Thus we would not support the exclusion of enterprises other than insurance companies from the scope.

Non-insurance companies should be able to obtain sufficient information from the terms of the insurance or reinsurance contract and cash flows resulting from the contract to enable them to apply the provisions of this SOP.

Issue 2: This proposed SOP identifies four kinds of contracts and provides guidance on accounting for these kinds of deposit categories. Is there a need for guidance for all four kinds of contracts identified in the proposed SOP?

Yes, there is a need for guidance on all four types of contracts, since each type transfers different risks and therefore requires different treatment.

Issue 3: This proposed SOP would require adoption at the beginning of the entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). The effect of initially adopting this proposed SOP should be reported as a cumulative effect of a change in accounting principle (in accordance with the provisions of APB Opinion 20). Would another method of transition be more appropriate?

No. The transition method appears reasonable. Any changes by an enterprise in their application of deposit accounting due to this SOP should be accounted for as a cumulative effect adjustment in the financial statements.

Issue 4: This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1998, with earlier adoption permitted. Is the effective date appropriate?

The effective date is appropriate and reasonably allows companies one year to implement the provisions of the SOP.

AICPA

Peer Review Program
American Institute of Certified Public Accountants
Administered by the
Illinois CPA Society

10/1/97 (17)

October 1, 1997

Mrs. Elaine M. Lehnert, Technical Manager
Accounting Standards, File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036

Dear Ms. Lehnert:

The Committee on Accounting Principles of the Illinois CPA Society (Committee) is pleased to comment on the Proposed Statement of Position--Deposit Accounting: Accounting Insurance for Reinsurance Contracts that do not Transfer Insurance Risk (SOP), dated June 30, 1997. The organization and operating procedures of the Committee are reflected in the Appendix to this letter. These recommendations and comments represent the position of the Illinois CPA Society rather than any of the members of the Committee and of the organizations with which they are associated. The Committee was assisted in the preparation of these comments by the Illinois CPA Society's Insurance Companies Committee.

Issue 1

No Comment

Issue 2

We agree that the SOP should provide guidance on accounting for all four kinds of contracts identified in the proposed SOP.

Issue 3

We agree with the proposed method of accounting for the transition as described in paragraph 20.

Issue 4

We agree with the proposed effective date.

17

Other comments

We believe that paragraph 8, which refers to the kinds of contracts to which the proposed SOP applies, should also refer to reinsurance contracts for which it is not reasonably possible that the reinsurer may realize a significant loss from the contract (as described in paragraph 9b of FAS #113)

Although we believe that the guidance provided in paragraph 13 is theoretically correct, we question whether it is appropriate to recognize contracts that transfer only significant underwriting risk at estimated present values when all other "long tail" reinsurance recoverable and unpaid losses are recognized at ultimate values. In spite of the reasoning put forth in paragraph 28, we believe that present value accounting for a relatively small portion of most insurance entities' reinsurance recoverables and unpaid losses is not appropriate until all "long tail" reinsurance recoverable and unpaid losses are accounting for at present value.

As stated in paragraph 14, we do not believe that the reduction in the deposit related to the unexpired portion of the coverage provided should be recorded by insurance enterprises as an adjustment to incurred losses, but should be recorded as an adjustment to earned premiums, just like changes in unearned premiums.

With respect to paragraph 17, we believe that when sufficient information becomes available to reasonably estimate and allocate premiums, if it is then determinable that the insurance or reinsurance contract actually did transfer insurance risk, the contract should be accounted for as a risk transferring contract. Just because FAS #113 did not provide for subsequent reevaluation of a contract is not sufficient basis to require deposit accounting for a contract that actually transfers insurance risk. In other areas of accounting, it is not uncommon to change the method of accounting for a given transaction as more, and better information becomes available.

With respect to the required disclosure identified in paragraph 19b, we question why these changes in estimates need to be disclosed when material changes in loss reserve estimates are not presently disclosed in GAAP basis financial statements.

We will be happy to discuss our comments and recommendations with you at any time. Please contact Loren B. Kramer, Chair Technical Response Subcommittee, Insurance Companies Committee at 847/432-2250.

Very truly yours,

Wayne J. Shust

Wayne J. Shust
Chair, Committee on Accounting Principles

(17)

APPENDIX A

ILLINOIS CPA SOCIETY
ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES

1997 - 1998

The Accounting Principles Committee of the Illinois CPA Society (the Committee) is composed of 30 technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 15 years. The Committee is a senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting principles.

The Committee usually operates by assigning a subcommittee of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting principles. It also requests participation in responses from industry-specific committees from the society. The subcommittee and/or industry-specific committees ordinarily develop a proposed response which is considered and discussed by the full Committee. The full Committee then issues a formal response, which at times, includes minority viewpoints of the committee and attachments containing comments from industry-specific committees.

10/7/97 18

COMMERCIAL RISK

Partners in Risk Management ®

October 7, 1997

Elaine M. Lehnert, Technical Manager
Accounting Standards
File 3162.DA
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk

Thank you for the opportunity to comment on the exposure draft, "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk."

General Comments

The exposure draft, for the most part, addresses the accounting by ceding companies (or insureds). For most insureds and ceding companies, involvement in a contract that does not transfer risk will be an unusual or isolated event. Buyers of insurance generally would not enter into a large number of nonstandard insurance arrangements. Insurance companies that follow U.S. GAAP generally would not enter many ceded reinsurance contracts that do not transfer risk because of the accounting restrictions imposed on such contracts. However, reinsurance companies may be more likely to be affected by the exposure draft because of the volume of assumed reinsurance contracts that they enter. When you review the exposure draft, it would be beneficial to consider its application to assuming companies.

My principal concern with the deposit method is that it provides little information about the activities of insurance companies that may be involved in numerous reinsurance transactions. Often the difference between a reinsurance contract that transfers risk and one that does not is a difference in degree (of risk), not a difference in the nature of the activity. For reinsurance contracts that transfer risk, the financial statements provide information about the volume of business (premiums written), time periods involved (earned and unearned premiums), acquisition costs, premiums receivable or payable, and losses paid, in addition to liabilities for unpaid losses. The deposit method, however, nets all of this activity into one number in the balance sheet. The income

(18)

effects of this activity are obscured by being included in interest income and expense. This inclusion of the effects of underwriting activity in interest income and expense may make it difficult for users of financial statements to analyze, for example, investment activity or financing activity. Also, there is the potential that many commonly used financial ratios will be distorted by deposit accounting, for example, premiums to surplus, reserves to surplus, loss ratios, etc.

I realize that the exposure draft did not invent deposit accounting and the AICPA cannot change the requirement that deposit accounting be used. However, it is unfortunate that we are stuck with an accounting model that was not well thought-out before it was imposed. It would have been better if the FASB had maintained one accounting model and simply deferred the gain or loss on non-risk contracts, rather than imposing a second and inconsistent accounting model for those contracts.

Adjustment of Timing of Future Cash Flows

Paragraph 11 states, "...if a change in the actual or estimated timing or amount of cash flows occurs, the effective yield should be recalculated..." Although materiality is always a consideration, it would be helpful to modify this statement to refer to "significant" changes in future cash flows. Cash flows from reinsurance contracts are inherently "lumpy." Even with contracts that have no underwriting risk, the occasional payment of large losses will make cash flows lumpy. In estimating future cash flows, we generally predict some sort of smooth curve of flows over relatively long periods of time (e.g., in one-year chunks). We cannot predict when the lumps will come or how big the lumps may be. When lumps occur, they do not necessarily indicate that prior estimates were wrong or that future estimates necessarily must be significantly adjusted. Although it may be prudent to revise estimates frequently, the exposure draft should allow some scope for judgment in this area.

Loss Recognition

The exposure draft should specify that the concept of loss recognition applies to deposit accounting by the assuming company. With regard to the effective yield approach, paragraph 11 simply states that a new effective yield should be calculated when estimates of the amount and timing of cash flows change. Such changes, for example, a significant shortening of the pay-out pattern, could result in an effective yield in excess of the assuming company's investment returns. In that case, the deposit liability balance as of the current date should be adjusted such that the effective yield over the remaining future cash flows does not exceed expected investment returns.

The following is an example of loss recognition under the effective yield deposit method. Based on initial estimates of future cash flows, the calculated effective yield is 6.3%. Let's assume that the assuming company can invest the cash at 7%. The assuming company can therefore expect a profit in the form of an investment spread of 70 basis points.

Original Estimate

18

Effective Yield 6.3%.

Year	Cash Flows Inflows	Outflows	Deposit Balance	Change in Deposit
0	6,000,000		6,000,000	
1		(400,000)	5,976,621	(376,621)
2		(1,200,000)	5,151,775	(375,154)
3		(1,800,000)	3,675,153	(323,378)
4		(1,600,000)	2,305,843	(230,690)
5		(1,000,000)	1,450,582	(144,738)
6		(800,000)	741,635	(91,053)
7		(600,000)	188,187	(46,553)
8		(200,000)	(0)	(11,813)
Total	6,000,000	(7,600,000)		(1,600,000)

Now let's assume that at the end of year 2, it is obvious that cash outflows will be faster than expected. The deposit amortization schedule is revised as follows:

18

Revised in Year 2

Effective Yield 8.9%

Year	Cash Flows Inflows	Outflows	Deposit Balance	Change in Deposit
0	6,000,000		6,000,000	
1		(400,000)	6,134,131	(534,131)
2		(3,000,000)	3,680,203	(546,072)
3		(2,400,000)	1,607,822	(327,619)
4		(1,200,000)	550,953	(143,131)
5		(600,000)	0	(49,047)
6		-	0	(0)
7		-	0	(0)
8		-	0	(0)
Total	6,000,000	(7,600,000)		(1,600,000)

The effective yield on the liability no exceeds the company's expected investment return on the cash. To be consistent with the premium deficiency concept of insurance accounting, this future loss should be recorded currently. The following is an example of how the liability should be adjusted in a loss recognition situation. Essentially, the effective yield is et equal to the investment return rate of 7%, and the deposit balance at the end of year two is forced.

Loss Recognition in Year 2

Effective Yield 7.0%

Year	Cash Flows Inflows	Outflows	Deposit Balance	Change in Deposit
0	6,000,000		6,000,000	
1		(400,000)	5,976,621	(376,621)
2		(3,000,000)	3,780,896	(804,275)
3		(2,400,000)	1,645,559	(264,663)
4		(1,200,000)	560,748	(115,189)
5		(600,000)	-	(39,252)
6		-	-	-
7		-	-	-
8		-	-	-
Total	6,000,000	(7,600,000)		(1,600,000)

You may notice that this calculation is the same as that shown in paragraph 46 of the exposure draft, except that the preceding example uses the investment return rate, (which is appropriate for loss recognition purposes), while paragraph 46 uses a risk free rate of return.

18

Discount Rate

For contracts that transfer underwriting risk only, the exposure draft states that once a loss occurs, the deposit should be measured by the present value of the future cash flows. Paragraph 15 states that risk-free investment rates should be used to discount the future cash flows. I believe that the exposure draft should state that, in the absence of a reasonable explicit interest rate, a risk-free rate should be used.

For example, consider a fairly typical post-funded contract. The ceding company pays a relatively small annual deposit premium. If a loss occurs, the loss will be repaid with interest in the form of additional premiums over future years. The additional premiums may be determined based on an experience account calculated as premiums paid, less losses recovered, plus interest (say, Treasuries plus 100 basis points) on any negative balance.

For this contract, it would be appropriate to earn the deposit premium over the coverage period. Following a loss, the expected future additional premiums would be accrued (as a liability by the ceding company and an asset by the assuming company). Interest would be accrued over the payback period at the stated interest rate. In this case, discounting the expected future cash flows at a risk-free rate probably would result in front-ending interest income by the assuming company.

Deposits Related to Unexpired Coverage

Paragraph 14 states that the "reduction in the deposit related to the unexpired portion of the coverage provided" should be recorded as a adjustment to incurred losses. Consider a contract for which ultimately no losses are incurred (such as an excess of loss contract). For an assuming company, the inclusion of this deposit in income over the coverage period is comparable to the earning of a premium or fee, and it should be considered revenue, rather than as a negative incurred loss. The inclusion of this amount in incurred losses could distort loss ratios.

Deposits with Negative Amortization

The exposure draft assumes that the consideration paid by the ceding company will be less than the future reimbursements to be received. Although this is often the case, it is not always the case. The exposure draft should clarify the application of the deposit method in this circumstance. For example, should the "negative amortization" of the deposit be recognized over the payout period, or should the ceding and assuming companies recognize currently the related expense and income (i.e., the difference between the consideration paid and the expected reimbursements).

Other Comments

There probably are many contracts that do not quite fit the two accounting approaches presented by the exposure draft. It may not be difficult to determine reasonable

12

accounting for these contracts within the spirit of the exposures draft; however, the specific guidance of the exposure draft may not be applicable. It may be helpful if the exposure draft would describe the general objectives of the deposit method, so that the accounting for unforeseen types of contracts can be evaluated.

Very truly yours,

Brian Zell
Senior Vice President and CFO

ERNST & YOUNG LLP
■ 1285 Avenue of the Americas
New York, New York 10019
■ Phone: 212 773 3000

(19)

10/8/97

October 8, 1997

Ms. Elaine M. Lehnert, Technical Manager
Accounting Standards Division, File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Proposed Statement of Position
Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that do not Transfer Insurance Risk

Dear Ms. Lehnert:

We support the issuance of the Proposed Statement of Position ("SOP") because we believe that guidance is necessary with respect to how deposit accounting should be applied to insurance and reinsurance contracts that do not pass risk transfer requirements. However, in order for non-insurance companies to be able to implement the proposed SOP, we believe that additional guidance is necessary. This concern and other comments on the proposal are discussed below.

Scope

The proposal is generally written for insurance and reinsurance companies, however, it includes non-insurance companies in its scope. In contrast to reinsurance, we are concerned with the lack of guidance regarding when to apply deposit accounting for insurance contracts and view it as an obstacle for non-insurance companies to comply with the SOP. Further, insurance companies may also have difficulty to comply with the SOP for contracts other than reinsurance. Accordingly, even though the determination of when to apply deposit accounting is beyond the scope of the SOP, we recommend that examples of insurance contracts that require deposit accounting be included in the SOP. This is necessary in order to assist non-insurance enterprises as they attempt to determine *when* to use the new model.

An example of a common contract for which it may not be clear whether deposit accounting should be applied by non-insurance enterprises is the incurred or paid loss retrospectively rated contract. These contracts often combine elements of both insurance and self-insurance. For those contracts where it is remote that insured losses will exceed the maximum premium that could be retrospectively assessed, it is reasonable to conclude that significant underwriting risk is not present. This arrangement could be one for which deposit accounting could be applied but, in practice, most non-insurance companies account for it as insurance.

As a long-term solution to this question, we believe that a project be undertaken to clarify Paragraph 44 of Financial Accounting Standards No. ("FAS") 5, *Accounting for Contingencies*, as it relates to when to apply deposit accounting for insurance contracts. This project should consider whether the guidance in FAS 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, would have applicability to non-reinsurance contracts and would need to consider the different legal rights each party has under these contracts.

Kinds of Contracts

We concur with the SOP's use of the three kinds of deposit categories and believe they adequately address the accounting for contracts that require deposit accounting. While paragraph 9 of the proposed SOP indicates that the initial deposit be measured based on the consideration less any explicitly identified fees, it does not indicate how such fees (typically referred to as risk charges or margins) should be recognized in the income statement. We believe such fees should be earned ratably over the contract period rather than at inception and recommend clarifying this in the final SOP.

We also have the following recommendations with respect to the guidance provided for contracts that transfer only significant underwriting risk:

- We recommend revising the classification of the consideration paid for coverage from a loss expense to a charge to revenue for the ceding company. We believe reflection of the consideration paid as premium is a more appropriate income statement display for contracts with significant underwriting risk.

- Although experience accounts are prevalent in these reinsurance contracts, the proposed SOP is silent as to how to account for them. We therefore believe that the SOP should clarify how these experience accounts should be viewed in determining the deposit. If there are no losses ceded or the present value of ceded losses is less than the experience account balance, should the deposit be equal to the experience account? Or, on the other hand, should the experience account be viewed as one of the cash flows under the contract and as such, be discounted from the valuation date to the date the contractholder would expect to commute the contract? If the latter is the case, should the discount rate be the risk free rate discussed in the SOP or the rate specified in the contract? If the discount rate used differs from the contractual rate, the ceding company could have a loss and the assuming company a gain at the inception of the contract. We recommend that the guidance specify that the experience account balance represents the deposit until the discounted loss recoveries exceed the balance.

- According to Paragraph 15 of the SOP, the discount rate used to calculate the present value of future cash flows is to be established at the date of each loss occurrence and used for the remaining life of the contract. We suggest that the SOP indicate the rationale used to reach this conclusion including support for its position from other accounting guidance. Furthermore, we believe additional guidance would be useful as to how to determine the date of each loss occurrence for contracts that reinsure a book of business as a whole such as an aggregate excess of loss cover.

Disclosures

While we assume that the disclosure requirements in paragraph 19 of the proposed SOP allow for the aggregation of contracts, it is not readily apparent. We therefore suggest that the final standard clarify that presentation by individual contract is not mandated.

Transition

We believe the method of transition is appropriate.

Effective Date

We believe the proposed 1999 effective date is reasonable.

We would be pleased to discuss our comments and recommendations with members of the Accounting Standards Executive Committee or its staff.

Sincerely,

Ernst + Young LLP

ARTHUR
ANDERSEN

10/7/97 20

Arthur Andersen LLP

33 West Monroe Street
Chicago IL 60603-5385

October 7, 1997

Ms. Elaine Lehnert
Technical Manager
Accounting Standards
File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Lehnert:

This letter sets forth our comments on the AICPA's June 30, 1997, Exposure Draft, "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk," (the ED). We appreciate the opportunity to provide our views about draft.

OVERALL COMMENT

We believe the ED should be issued as a final SOP. For years, the accounting literature has required deposit accounting for insurance contracts that do not transfer risk, but the literature never has defined what deposit accounting means. For contracts that transfer only timing risk, we believe accountants generally adopted the interest method in practice. However, for contracts that transfer underwriting risk or have indeterminate risk, which seem to have proliferated in recent years, accountants were genuinely confused about how to apply deposit accounting. The ED resolves this confusion. We believe the provisions of the ED are appropriate and clear. Our specific comments follow.

RESPONSE TO SPECIFIC ISSUES

Issue 1: Scope. The scope of the ED is appropriate. Enterprises other than insurance enterprises enter into insurance contracts that do not transfer risk and are required by existing accounting literature to use deposit accounting. Those enterprises need guidance on how to implement deposit accounting just as insurance enterprises do. We are not aware of any problems that non-insurance enterprises will face in obtaining sufficient information to apply the provisions of the ED. Our experience is that insurance contracts that do not transfer risk generally are entered by larger enterprises that have the accounting and risk management resources to understand the contracts, obtain the necessary information, and make the necessary journal entries.

Issue 2: Kinds of Contracts. Guidance is needed on all four types of contracts. All four exist in practice today, and as we noted in our general comments, accountants have been confused about how to apply deposit accounting to the contracts described in paragraphs 8.b. and 8.d.

Issue 3: Transition. Transition is essentially a practical decision in all pronouncements. The required adoption at the beginning of a fiscal year via a cumulative catch-up adjustment is both the easiest and the most understandable.

Issue 4: Effective Date. The proposed effective date of fiscal years beginning after December 15, 1998 is appropriate, provided that the final SOP is issued early in 1998

OTHER COMMENT

The entire focus of the ED is on the measurement of the deposit asset or liability account and the classification in the income statement of adjustments to the deposit account. It would be desirable from the standpoint of completeness to discuss the accounting for premiums received or paid on contracts that do not transfer insurance risk. The implication of the ED is that premiums paid should be recorded directly as a deposit asset and not as an expense, and that premiums received should be recorded directly as a deposit liability and not as revenue, but the ED never explicitly says so. This would be a significant change in practice for certain captive insurance entities that enter contracts with their parent organizations designed to yield zero net income. Therefore, we believe that it would be desirable to address the issue explicitly.

We would be pleased to discuss any of our comments with representatives of the AICPA at their convenience.

Very truly yours,

Arthur Andersen LLP

(21)

General Re

General Reinsurance Corporation
Financial Centre
PO Box 10350
Stamford, CT 06904-2350
203 328-5620
203 328-5061 Facsimile

David C. Corr
Second Vice President

Rec'd
10/17/97

By Facsimile

October 17, 1997

Ms. Elaine Lehnert, Technical Manager
Accounting Standards, File 3162.DA
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Proposed Statement of Position

Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk

Dear Ms. Lehnert:

As a member of the Reinsurance Association of America (RAA), an organization of twenty-nine United States property and casualty reinsurance companies, we strongly support the RAA's comments on the exposure draft and ask that the AICPA give them serious consideration. In addition, we would like to make the following points concerning the proposed SOP.

In particular, we agree with the RAA's concerns that the accounting proposed for Type B deposit contracts will undermine the accounting established by SFAS No. 113 by allowing a form of reinsurance accounting for deposit contracts that failed to meet the risk transfer requirements of SFAS No. 113. The FASB deliberately classified all contracts that delayed timely reimbursement as deposits. Accordingly, these contracts should be treated as financing transactions. The proposed SOP contradicts the spirit of the FASB's decision and allows deposit contracts to receive "back door" reinsurance accounting, notwithstanding the FASB's intent to distinguish deposit accounting from reinsurance accounting.

One additional concern we have with the SOP, which was not addressed in the RAA comment letter, is the accounting for retroactive deposit contracts. The proposed

SOP does not make a distinction between prospective and retroactive contracts and fails to provide specific accounting guidance for retroactive deposit contracts. SFAS No. 113 made a clear distinction between prospective and retroactive contracts by requiring different accounting treatment. Prospective contracts are reported as prepaid reinsurance and are amortized over the contract period, whereas retroactive contracts are reported as reinsurance receivables with the amount of the recorded liabilities that exceed the amount paid being amortized into income over the remaining claims settlement period.

For Type B deposit contracts the proposed SOP requires the initial amount paid to be amortized over the unexpired portion of the coverage provided. No accounting guidance is provided in the SOP for how this payment should be amortized for retroactive deposit contracts since the coverage period has already expired. Does the SOP require the amount paid for a retroactive contract to be charged to income immediately since the coverage period is for past events, or should it be amortized over some other time period? The amortization period for these types of contracts should be clearly stated in the SOP.

In addition, the risks assumed by the reinsurer in retroactive contracts are fundamentally different than for prospective contracts since the insured event has already occurred. Contracts of this type primarily consist of loss portfolios or adverse loss development covers. For a contract to qualify as a Type B retroactive deposit contract, it would most likely contain a delayed reimbursement clause, therefore mitigating timing risk but transferring underwriting risk. This SOP allows the time value of money component of this type of deposit contract to be recorded as an offset to incurred losses. We believe this is inappropriate.

In summary, we agree that the industry is in need of accounting guidance for deposit contracts due to the variance in current practice. We believe, however, the proposed SOP contradicts current accounting guidance promulgated by the FASB for the reasons stated above.

Sincerely,

David G. Corr

David G. Corr

NJSCPA
1898 • 1998 100 Years and Beyond
New Jersey Society of Certified Public Accountants

425 Eagle Rock Avenue
Roseland, New Jersey 07068-1723
(973) 226-4494
Fax (973) 226-7425
FaxCPA (973) 364-0380
http://www.njscpa.org
e-mail: njscpa@njscpa.org

22
Rec'd Oct 21, 1997

October 14, 1997

Ms. Elaine M. Lehnert, Technical Manager
Accounting Standards - File 3162.DA
American Institute of Certified
Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Lehnert:

The Auditing and Accounting Standards Committee (the "Committee") of the New Jersey Society of Certified Public Accountants ("NJSCPA") is pleased to submit its comment regarding the American Institute of Certified Public Accountants ("AICPA") proposed Statement of Position entitled *Deposit Accounting: Accounting for Insurance and Re-Insurance Contracts that Do Not Transfer Insurance Risk* (the "Proposed SOP"). The viewpoint expressed herein represent the majority of a quorum of the members of the Committee and is not necessarily indicative of the full membership of the NJSCPAs.

In our review of the Proposed SOP, we were unable to ascertain whether or not some non-insurance enterprises will have difficulty obtaining sufficient information and data to enable them to apply the provisions of the Proposed SOP. Consequently, we believe that the statement should be field-tested for this purpose before applicability to non-insurance entities is resolved. Furthermore, the need for additional procedural and disclosure guidance for non-insurance entities should be determined based on the field-test results.

NJSCPA 1898 · 1998 100 Years and Beyond
New Jersey Society of Certified Public Accountants

22

We appreciate your consideration of our comments. We would be pleased to discuss our comment with the Board or its staff.

Very truly yours,

John A. Fazio, CPA, Chairperson
Auditing and Accounting Standards Committee

JAF:lc

cc:	Kenneth W. Moore, CPA	- President
	Daniel J. Meehan, CPA	- President-Elect
	William M. Collister, CPA	- Trustee
	John A. Demetrius, CPA	- Trustee
	Joseph F. Scutellaro, CPA	- Trustee
	Merryl A. Bauer	- Executive Director

300 Atlantic Street
P.O. Box 9316
Stamford, CT 06904

Telephone 203 358 0001

Price Waterhouse LLP

23

Rcv'd 10-29-97

October 23, 1997

Ms. Elaine Lehnert
Technical Manager - Accounting Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Lehnert:

File 3162 - Exposure Draft
Proposed Statement of Position
Deposit Accounting: Accounting for Insurance and
Reinsurance Contracts that Do Not Transfer Insurance Risk

We appreciate the opportunity to comment on the Exposure Draft of the Proposed Statement of Position, "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts that Do Not Transfer Insurance Risk" (the SOP). We recognize that the deposit method of accounting is required by existing accounting literature such as FASB Statements No. 5 and No. 113 and EITF Issues No. 93-14 and No. 93-6; however, existing pronouncements do not describe what is meant by deposit accounting or how it should be applied. We believe that this SOP will resolve diversity in practice with respect to the application of deposit accounting.

Specific Issues Requiring Attention by Respondents

The following responses address the specific issues for which AcSEC had requested feedback in the Exposure Draft:

1. The proposed SOP would apply to all enterprises, including insurance enterprises and other enterprises. Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not?

   We believe that the inclusion of both insurance and non-insurance enterprises within the scope of the SOP is appropriate. Given the economic nature of the contracts included in the scope of the SOP, entities entering into such arrangements should have sufficient information regarding timing and underwriting risks assigned or assumed to apply the provisions of the SOP.

2. This proposed SOP identifies four kinds of contracts and provides guidance on accounting for these kinds of deposit categories. Is there a need for guidance for all four kinds of contracts identified in this proposed SOP?

   Since both timing risk and underwriting risk need to be transferred in order for insurance risk to be transferred, three possible arrangements exist that do not result in the transfer of insurance risk: timing risk only, underwriting risk only and neither timing risk nor underwriting risk. We believe that all of these potential contractual arrangements are appropriately addressed by the accounting guidance in the SOP. We also agree that the SOP should consider contracts where the level of risk assigned or assumed is not determinable.

3. This proposed SOP would require adoption at the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). The effect of initially adopting this proposed SOP should be reported as a cumulative effect of a change in accounting principle (in accordance with the provisions of APB Opinion 20). Would another method of transition be more appropriate?

   We agree with AcSEC's conclusion with respect to adoption timing and method (cumulative effect) for the SOP. We do not believe that another method of transition would be more appropriate.

4. This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1998, with earlier adoption permitted. Is the effective date appropriate?

   We believe that the proposed effective date indicated in the SOP is appropriate.

<u>Other Matters</u>

Paragraphs 12 and 46 of the SOP indicate that, for contracts that transfer only significant timing risk, a significant change in the total amount of actual and estimated cash flows may indicate that the contract does include significant underwriting risk. For that reason, the SOP indicates the contract should be converted to the accounting for contracts that transfer only significant underwriting risk. It is unclear to us why the contract would not be considered to be more like an insurance contract that transfers both significant underwriting and timing risk. We recommend that the reason be explained in the Basis For Conclusions for converting the contract to the accounting for contracts that transfer only significant underwriting risk and not to the accounting for contracts that transfer both underwriting and timing risk.

The SOP indicates that, once a loss is incurred under a contract that transfers only significant underwriting risk, the deposit is measured by the present value of the expected future cash flows arising from the contract plus the remaining unexpired portion of the coverage provided.

23

We recommend that the SOP provide guidance about how the unexpired portion of the coverage provided is to be determined similar to the guidance provided in paragraph 13 of FASB Statement No. 60.

We note from the Basis For Conclusions that AcSEC considered a variety of discount rates to be used in determining the present value of the expected future cash flows arising from a contract that transfers only significant underwriting risk. It would be helpful to explain why AcSEC concluded that the rate should be established at the date of the loss and used for the remaining life of the contract.

We recommend that the second and final sentence of paragraph 3 of the SOP be deleted. The second sentence is describing the same insurance risk criteria already addressed in paragraph 2 of the SOP. The last sentence is misleading because it implies that accounting guidance *exists* on a case by case basis when in fact accounting guidance *is applied* on a case by case basis.

We recommend that the words "insurance and" be inserted in paragraph 6.b. of the SOP after "multiple year retrospectively rated" and before "reinsurance contracts".

* * * * * * * * * * * * * * *

We will be pleased to discuss further matters raised in this letter. Should you wish to do so, please contact Deidre Schiela at (203) 316-5748.

Very truly yours,

Price Waterhouse LLP