AMERICAN ACADEMY of ACTUARIES

May 29, 2001

Peter Clark
Senior Research Manager
IASB
166 Fleet Street
London EC4A 2DY
United Kingdom

Dear Peter,

The American Academy of Actuaries (Academy) Task Force on Fair Value is currently preparing its comment letter with respect to the report on Financial Instruments prepared by the Joint Working Group of National Standard Setters.

We understand that these comments are being received at the same time as the Insurance Steering Committee is winding up its work and is preparing a Draft Statement of Principles (DSOP) for review by the new International Accounting Standards Board (IASB). It is possible that the submitted DSOP will address these issues, but we thought it might be helpful to that process for the Steering Committee to understand a concern raised by the Academy Task Force in distinguishing certain products and assets between the Joint Working Group documents and the documents issued by the Insurance Steering Committee.

We are writing to you to describe an area of potential concern when the IASB addresses accounting for insurance products. We will express the same potential concern in our commentary on the Joint Working Group report even though insurance is explicitly excluded from its current deliberations.

Our potential concern has to do with potential hybrid instruments as expressed below. We are not clear as to whether this example is a hybrid instrument or not, but it raises a problem regardless.

Potential Hybrid Instrument question

We understand that insurance is currently excluded from the JWG draft (except for embedded options). Nevertheless, we have been trying to understand whether certain common forms of insurance (in the United States) would meet the definition of financial instruments, if they were not excluded from the scope. These forms of insurance promise a service or services, rather than a financial amount.

Consider the following.

> An insurance company (A) issues a medical insurance policy (B) to a policyholder (C). B commits A to secure necessary medical services for C, provided C pays the premiums specified in B. Under B C must make a co- payment if he uses medical services. This co-payment is lower if C uses a chain of medical centers (D) with whom A has a contract.
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> When a person other than a policyholder of A uses D that person is charged for service by D according to a specified tariff. A's contract with D specifies that A will reimburse D for services provided to policyholders of A at 70% of the retail tariff in recognition of A's excellent payment history, and A's attempting to steer its policyholders to D.

Is this example intended to be a financial instrument? If so how is it to be valued? The commitment under B is obviously for service, not money. Further the value of that service has, in effect, a retail and a wholesale price.

Please contact Meredith Watts with the Academy when you are ready to discuss this hybrid question further at 202-223-8196 or watts@actuary.org.

Sincerely,

Burton Jay

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