



03.January.2006

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**RE:** Selected Issues Relating to Assets and Liabilities with  
Uncertainties - File Reference No. 1235-001

Dear Ms. Bielstein:

The chief financial officers of leading insurance companies including life insurers, property and casualty insurers, and reinsurers formed the Group of North American Insurance Enterprises (GNAIE) in 2003. GNAIE members include the largest global providers of insurance and multi-national corporations. All are major participants in the US markets. The goal of GNAIE is to influence international accounting standards to ensure that they result in high quality accounting standards for insurance companies and, to that end, to increase communication between insurers doing business in North America, the International Accounting Standards Board (IASB) and the United States Financial Accounting Standards Board (FASB). GNAIE works to meet its goals through modeling of proposed accounting standards, analysis, comment, and coordination with various end users of financial reports.

We thank you for the opportunity to comment on the recently issued Invitation to Comment *Selected Issues Relating to Assets and Liabilities with Uncertainties*. We will provide general comments as well as address the questions in the Invitation to Comment. Previously, we have sent you our comment letter to the IASB on its Exposure Draft of Proposed Amendments to *IAS 37 Provisions, Contingent Liabilities and Contingent Assets*. We would ask you to consider those comments in addition to our comments here.

We support convergence between International Accounting Standards and U.S. GAAP and are encouraged by the stated goals of the exposure draft; however, we have serious concerns:

- We do not believe that current U.S. GAAP is improved by recording a liability for an obligation that is not probable or recording an impairment of an asset that is not probable.
- The Invitation to Comment creates new liability recognition and measurement criteria that may have far reaching

To influence the development of international accounting standards to ensure that they result in robust, high quality standards for insurance enterprises

implications when these criteria have not been fully vetted by either the FASB or IASB within their framework projects.

- The potential that entities will record liabilities for which the likelihood of cash outflow is remote is a major change in the accounting literature that should be deliberated with great care.
- We do not believe the guidance would improve financial reporting since recording many of the liabilities that are subject to this guidance would involve highly subjective and uncertain estimates.
- We do not believe that discounting probability weighted cash flows for a single liability is appropriate since it is not statistically reliable. It is only appropriate for a homogenous group of liabilities (law of large numbers).
- We believe that adequate disclosure of non-probable risks and uncertainties is more understandable for, and more appropriately used by, the end users of the financial statements. We believe that recording non-probable liabilities implies to users an artificial level of precision that does not exist and users will overly rely on such recorded amounts.
- We strongly disagree with the assertion that “except in extremely rare cases, an entity will be able to determine a reliable measure of a liability”. For example, most lawsuits in the United States (U.S.) cannot be reliably measured until the case is fairly advanced due to the structure of the legal system in the U.S. where plaintiffs have the right to a jury trial, punitive damages can be and are assessed, there is no cost shifting of trial expenses to unsuccessful plaintiffs and awards are not prescribed.

Although we believe fair value for some assets and liabilities can be reliably measured, such as those with observable markets, we do not believe that fair value measurement is appropriate for non-financial liabilities since there is no established market for most of these liabilities and the use of discounted cash flows will result in highly unreliable and non-comparable financial statements.

A major concern for U.S. registrants and their liability insurers is the potential change in the litigation environment as a result of the proposed amendments. Companies would be forced to record and disclose estimates prior to any substantial negotiation with the plaintiff. We believe this would cause an increase in ultimate settlement amounts as a result of providing the plaintiff with a stronger negotiating position as this information will be available to the plaintiff in the discovery process. Once the plaintiff gains access to the defendant’s calculation of the recorded liability, they will be able to determine the gross amount that likely will establish the floor for future negotiations. For example, suppose that a company is served with a subpoena before the end of a quarter and it has enough information to record a liability, which is a relatively low hurdle in the exposure draft. The company would have to record a liability under this guidance even though the company believes it is probable that it will prevail and even though the measurement of the liability is very uncertain. In some cases, the amount recorded in the financial statements could be more than what the plaintiff is seeking; however, the recorded amount would be used by the plaintiff as a starting point in settlement negotiations. More importantly, the very nature of recording a liability will lend credibility to a lawsuit where the plaintiff otherwise had a low chance of prevailing, especially when the standard suggests that the liability is “measured reliably”. This information could be used in a court of law as evidence that the company acknowledges liability. We believe this guidance would complicate lawsuits for defendants and would influence companies to understate the

probabilities of various outcomes so as to minimize liabilities recorded because they could be used as evidence against them. Also, we believe paragraph 71 (disclosure exception) of the IASB’s Exposure Draft would not be helpful to defendants since it conflicts with applicable SEC disclosure rules.

Another concern for U.S. registrants is the potential increase in shareholder litigation due to shareholders relying on financial statement information that they believed was precise and certain, when in fact significant uncertainty was included in the statements. Recording and disclosing liabilities based on cash flow modeling and significant assumptions implies a high level of precision where none exists. There is no market for the sale or purchase of lawsuits nor of indemnification agreements relating to known lawsuits and without such a market it is extremely difficult to determine if the assumptions used in calculating these liabilities are appropriate.

This potential standard would put U.S. registrants and all companies conducting business in the U.S. in a precarious position. If a company records a liability that is too high it could lead to a settlement or judgment in excess of the true value of the lawsuit. Conversely if a company records a liability that is too low and subsequently pays an amount that is materially greater it may be the subject of a shareholder suit. Considering this environment further makes measurements under these proposed amendments extremely problematic.

Please find below our responses to the Questions found in the *Invitation to Comment*:

**Contingent Assets**

**Question 1:** Do you agree with eliminating the term contingent asset? If not, why not?  
**Question 2:** Do you agree with the IASB’s analysis of unconditional and conditional rights in contractual settings, as summarized in paragraphs 30 and 31 of this Invitation to Comment and paragraphs BC10-BC13 of the IASB Exposure Draft? If not, why not?

**No, we do not understand how eliminating the term contingent asset will improve financial reporting. We believe that contingent assets and intangible assets are different (see question 4 response). Accordingly, naming contingent assets “intangible assets” is extremely confusing. The theory that a contingent asset can be thought of as a conditional asset and an unconditional asset is flawed. The logic employed appears to be the following: the unconditional portion of a contingent asset is a non-monetary asset since there is not a fixed or determinable amount of money to be received; and since the unconditional asset is an identifiable non-monetary asset without physical substance it meets the definition of intangible asset. It is difficult to understand how a portion of a contingent asset would qualify as an intangible asset when the contingency will only be settled monetarily or will be written off when it is determined to have no value.**

**Question 3:** If you answered yes to Question 2, do you agree that the IASB has appropriately applied the notion and supporting reasoning referred to therein in the analysis of Examples 1-3 in paragraphs 33-35 of this Invitation to Comment? If not, why not?

**Not applicable.**

**Question 4:** Do you agree with the IASB’s proposal to classify as intangible assets those unconditional rights that are associated with conditional rights that satisfy the definition of an asset, without shifting the consideration of the uncertainty surrounding the conditional rights from recognition to measurement?

**No, we believe that contingent assets have significantly different characteristics than intangible assets. Intangible assets are other than monetary assets, controlled by the entity, provide a definite benefit and have either a definite or indefinite useful life. Contingent assets encompass monetary assets that are not controlled by the entity and are only potential assets of a company. We do not believe there is a need to revise the current guidance.**

**Contingent Liabilities**

**Question 5:** Do you agree with eliminating the notion of contingent liability? If not, why not?

**No, we do not understand how this change will improve financial reporting. We believe contingent liability is a well-understood term that adequately describes uncertain obligations. Furthermore, we find the term non-financial liability confusing where contingent liability is clear. Non-financial liability in plain language would be understood as one that would not settle through monetary payment. Although a careful reading will show that the intended meaning is a monetary liability other than pursuant to a financial instrument within the scope of IAS 39 and other than pursuant to another IAS, this is not intuitive. We recommend that the plain language term contingent liability be preserved.**

**Question 6:** Do you agree with the IASB’s analysis of unconditional and conditional obligations in contractual settings as summarized in paragraphs 39 and 40 of this Invitation to Comment and paragraphs BC24-BC28 of the IASB Exposure Draft? If not, why not?

**No, while we do understand the theoretical argument, we do not believe that bifurcating the contingency into two components to determine if either component meets the definition of liability is appropriate since, in most cases, the unconditional obligation and the conditional obligation are inseparable. The IASB’s Exposure Draft demonstrates this in using the projected cash outflows of the conditional obligation to value the unconditional obligation (the unconditional liability is not independent of the probability of the uncertain future events). If the obligations were truly separable, one would think that they would each have a value that is determined by its own characteristics.**

**Furthermore, we find the idea that an unconditional liability is based on the value of a conditional liability to be overly complex language when it appears that the intention is simply to have contingent liabilities be based on probability-weighted present values or “fair values”.**

**Additionally, we don't believe that it is appropriate to recognize a liability for contingencies that are not probable. This guidance will require a liability for any and all future events, which may or may not occur.**

**For example, every lawsuit filed against a company, as well as any potential unasserted lawsuits, would require establishing a liability since there is most likely some chance, no matter how remote, that the company may lose. This will have practical workflow issues as well, as companies that receive a significant number of lawsuits that are currently evaluated as not probable will now have to assign probabilities and value the contingencies as liabilities. Every reporting period, a review of each subjective factor used in valuing the lawsuit would have to be performed. Also, companies would have to look at all claims and potential claims since the aggregate value of immaterial lawsuits may be material. Further, identification of the potential contingency inventory is not possible or practicable. The reporting of these liabilities would imply a level of precision that does not exist, and at the cost of significant additional effort.**

**Question 7:** If you answer yes to Question 5, do you agree that the IASB has appropriately applied the notion and supporting reasoning referred to therein in the analysis of the example in paragraph 41 of this Invitation to Comment? If not, why not?

**Not applicable.**

**Probability Recognition Criteria**

**Question 8:** Do you agree with omitting the probability criterion for recognition of non-financial liabilities? If not, why not?

**No, we do not agree that probability should be removed from the recognition criteria. We believe liabilities should be subject to a recognition threshold or criteria. The current standard has been proven practicable to the entities applying the guidance and understandable to the end users of the financial statements. We do not believe that it is representationally faithful to record liabilities for which the entity believes the likelihood of a cash outflow is not probable and even remote as these measures are neither reliable nor relevant to financial statement users.**

**Measurement**

**Question 9:** Do you agree with the proposed measurement requirements for non-financial liabilities? If not, why not?

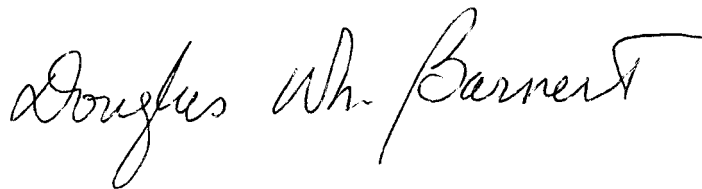
**No, we do not agree with the measurement requirements, and particularly in measuring a single obligation. Using probability weighted cash flow scenario analysis in measuring a single potential liability in itself is not statistically reliable due to the subjectivity of the assumptions (selection of probabilities, appropriate discount rate, risk adjustment and timing of cash**

outflows). Two entities subject to the same potential liability could calculate significantly different values due to the use of slightly different, yet both reasonable, assumptions. We do not feel that this proposed measurement criteria is any more reliable than the entity's best estimate.

Additionally, as previously stated, this measurement approach raises practical concerns if companies were required to implement this proposed guidance. Companies with a substantial volume of low-value lawsuits would have to spend a significant amount of time determining what the potential cash outflows could be, applying supportable probabilities to the estimated cash outflows and discounting those cash flows. We believe the costs of applying the guidance would far outweigh the benefits to the financial statement readers.

We also do not believe that adding an adjustment for risks and uncertainties in the IASB's Exposure Draft strengthens the argument for fair value measurement. In fact it highlights the very problem with this proposed guidance: that many of the non-financial liabilities recorded under this proposed guidance would be extremely uncertain as to timing, amount and whether or not they will ever come to fruition. Additionally, without an adequate proxy for risk margins and additional guidance on the adjustment for risks specific to the liability, preparers may employ significantly divergent assumptions leading to non-comparability of financial statements. We believe that adequate disclosure far outweighs recording uncertain liabilities and is significantly more understandable for, and more appropriately used by, the financial statement readers.

Respectfully submitted,



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Executive Director

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