



21.November.2005

Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116

RE: Working Draft Statement of Financial Accounting Standards No. 15X, *Fair Value Measurements* and the Proposed FASB Staff Position No. 133-a, *Accounting for Unrealized Gains (Losses) Relating to Derivative Instruments Measured at Fair Value under Statement 133*

Chair
Richard Carbone
CFO, Prudential Financial

Vice Chair
Jerry M. de St. Paer
CFO, XL Capital

Philip Bancroft
CFO, ACE Ltd.

Steven J. Bensinger
CFO, AIG

Danny L. Hale
CFO, The Allstate Corporation

Marc Meiches
CFO, GE Insurance Solutions

William G. Gasdaska
CFO, General Reinsurance

Richard P. McKenney
CFO Genworth Financial

Robert Price
Controller, The Hartford

Dennis Langwell
CFO, Liberty Mutual Group

Joseph J. Prochaska, Jr.
CAO, Metropolitan Life Insurance

Michael E. Sproule
CFO, New York Life Insurance

Douglas Wm. Barnert
Executive Director
40 Exchange Place, Suite 1707
New York, NY 10005
United States

++1-212-480-0808
info@gnaie.net
www.gnaie.net

Dear Sir/Madam:

The chief financial officers of twelve 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 Working Draft Statement of Financial Accounting Standards No. 15X, *Fair Value Measurements* and the Proposed FASB Staff Position No. 133-a, *Accounting for Unrealized Gains (Losses) Relating to Derivative Instruments Measured at Fair Value under Statement 133*.

We support the Board's objective of developing a statement to establish a framework clarifying the application of fair value measurement in current U.S. GAAP. We agree with the overall concept of the proposed Fair Value Measurement guidance as it pertains to current U.S. GAAP and understand the accounting concerns addressed in the proposed FSP; however, we have several serious concerns with the drafts.

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

Comments on Proposed FSP 133-a

- We are very concerned that the Proposed Staff Position No. 133-a inadvertently changes the current accounting for insurance company contracts that contain embedded derivatives as a result of the proposed changes to Derivatives Implementation Group Issue B6, *Embedded Derivatives: Allocating the Basis of a Hybrid Instrument to the Host Contract and the Embedded Derivative (Issue B6)* and we do not believe that it is the intent of the FASB. We recommend that contracts accounted for under Statements 60, 97, 113, and 120 be excluded from this FSP.

1. The proposed FSP would require insurance companies to defer the profit on host contracts as well as embedded derivatives.

Under current accounting for contracts issued by insurance companies, profits are recognized as revenues when earned, after any necessary provision for future benefits in excess of future revenues. The requirement to defer profits would be a fundamental change in accounting for the host contracts – affecting both their initial measurement and their profit recognition.

2. The proposed FSP could be interpreted to require that no profit be recognized on embedded derivatives until they expire (through maturity, exercise or lapse).

We believe the Board's intent was to defer profit recognition where gains were taken up-front. The Board wanted deferral because there was an insufficiently reliable basis for the difference between a transaction market price and a wholesale (dealer) market price. In the case of an embedded derivative in a retail annuity contract, the profit is not taken up front. The difference between the retail fees and the designated fees based on the wholesale-priced embedded derivative is recognized as earned and received over the life of the contract.

- We are concerned that there might be other unintended consequences of the proposed FSP and the 30 day comment period may not allow enough time to for preparers to identify all of the potential issues. Contributing to this, the late October/early November comment period included a time when many preparers were occupied with quarterly financial reporting which reduced their capacity to focus and devote effort to fully respond.
- This proposed FSP sets a precedent for the recognition of Level 5 measurements and should be well vetted prior to implementation. It is our belief that the facts and circumstances of the transactions giving rise to the Level 5 measurement should be considered in determining whether income statement treatment is warranted and there should not be a requirement to exclude Level 5 measurements from income statement recognition. There will be instances when internal modeling can be considered reliable and should warrant income statement treatment. This can be true when there are a significant number of observations on which the model can be based and the entity is able to back-test its model.

- We don't understand why the minimum reliability threshold (paragraph 4) in the FSP applies to the initial recognition but does not apply to the accounting for fair value estimates in subsequent periods. If the fair value estimate in subsequent periods is sufficiently reliable to record in the income statement, then we don't know what the basis would be for saying that it is not sufficiently reliable at initial recognition to base the embedded derivative's value upon.
- We would find it helpful to have examples and discussion in paragraph 4 of the Proposed FSP on the process by which an initial estimate that falls into Level 5 changes to a Level 4 estimate, and creates income or expense, as valuation inputs become verifiable. Guidance on reliability and verifiability in Fair Value measurement are not as developed as the hierarchy might suggest. We hope the Board and Staff will give greater attention to distinguishing valuation techniques that provide reliable estimates, from those that provide unreliable and potentially misleading extrapolations. It is not clear from the Proposed FSP or the Fair Value Measurement Working Draft whether preparers will be able to demonstrate they have used appropriate valuation methods. This will create a challenging area for preparers and auditors to reach agreement and for financial statement users to understand.

Comments on Fair Value Measurement Working Draft

- We are concerned with the potential significance given to the Fair Value Measurement guidance and its application to other projects, and in particular insurance related projects which have unique characteristics. The guidance states that it provides how to measure fair value when required by specific accounting pronouncements. The Background Information and Basis for Conclusions indicate that the Board plans to continue to address the issue of which measurement attribute should be required in individual accounting pronouncements on a project-by-project basis. While the Fair Value Measurement guidance provides a classification system for fair value estimates based on inputs, it does not provide a robust model that considers the unique characteristics of insurance contracts. For example, a significant component of a fair value measurement of a non-life reserve includes a risk margin for uncertainty. Currently, there is no reliable measure of a risk margin for uncertainty after the inception of a contract. Therefore, inclusion of a risk margin in insurers' financial statements, as is required by a fair value measurement, would result in balance sheets and income statements that cannot be relied upon by readers of insurance company's financial statements. We appreciate that some Board members share our concern about the reliability of some fair value measurements that are predicated on hypothetical transactions in hypothetical markets and that the Board plans to address measurement issues on a project-by-project basis. The Board should expressly acknowledge that it may need to expand on the fair value guidance in individual accounting pronouncements.
- The guidance discusses the impact of trading restrictions on securities but does not discuss assets or liabilities that are not legally transferable, which is a form of restriction. We believe that similar to restrictions on securities, non-transferability should impact valuation. For instance, if a bond is trading at 95 in the market and the debt does not contain a call option, in order for the issuer to retire the debt it would have to issue a tender offer with a price in most cases in excess of 95 as an incentive to the current holders to tender. We believe that this example illustrates that symmetry may not exist for the fair value of certain assets and the underlying liability due to the lack of

transferability of the liability. We believe that the lack of transferability would have to be considered in any deliberations on applying fair value to insurance liabilities.

- We believe the Fair Value Measurement guidance should not presume that own credit standing is relevant for the valuation of all liabilities. The facts and circumstances regarding a liability should be considered in determining whether own credit risk should be factored into the fair value measurement of the particular liability. We appreciate that some Board members share this belief, but we are concerned that in the Background Information and Basis of Conclusions the Board agreed with the conclusions reached in Concept Statement 7 and the Working Draft appears to make the use of own credit standing the rule. As discussed in the Working Draft, the use of own credit standing on issuer debt causes an impact to the financial statements which appears contradictory to the change in an issuer rating due to the inverse relationship. What may have been overlooked is that the fair value of the associated asset may not represent the liability layoff value due to restrictions placed on one side or the other.

We believe that this is also a critically important topic for the valuation of insurance liabilities. We believe that asset liability matching is very important for financial statement readers to understand when evaluating insurance companies and the use of own credit risk instead of a rate associated with the supporting investment portfolio would create more volatility that would need to be explained. We understand that some may theorize that two companies with different credit standings would have different time value components which would factor into their marketable asset values; however, we don't believe that this is appropriate to insurance contracts and some other liabilities. Ignoring that there is no secondary market to sell insurance contracts and they are not transferable, we don't believe that a purchaser would factor in the credit standing of the direct writer into its valuation. We believe the transferee would determine the price it would require to assume the liability based on the present value of the obligation and their ability to perform under the contract. The transferee would use its assumptions and not the transferor's.

We would be pleased to further discuss our comments with the Board and Staff.

Sincerely,

A handwritten signature in cursive script that reads "Douglas W. Barnett".

Executive Director