



April 1, 2009

Mr. Russell Golden
Technical Director
Financial Accounting Services Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: File Reference Proposed FSP FAS 157-e

Dear Mr. Golden,

The Group of North American Insurance Enterprises (“GNAIE”)¹ appreciates the opportunity to offer comments and observations on the Financial Accounting Standards Board’s (“FASB”) Proposed FASB Staff Position No. FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed* (“Proposed FSP”).

GNAIE has been a long-time advocate for the development of additional guidance for measuring fair value when markets are inactive, illiquid, and disorderly (hereinafter collectively referred to as “inactive”). Accordingly, we support the FASB’s efforts to further clarify how fair value should be measured in markets that are inactive and how to determine if transactions associated with those markets are distressed and thus should not be considered determinative in the measurement of fair value as set forth in SFAS 157.

We support the Proposed FSP as it is aligned with the objective of providing the most relevant, reliable, and transparent measurements of financial assets that require fair value measurement in situations where markets are inactive. In contrast, when markets are active, liquid, and orderly, existing guidance in SFAS 157 typically provides sufficient guidance for measuring the fair value of financial assets.

While some have suggested the Proposed FSP would produce measurements inconsistent with the exit value notion of fair value in SFAS 157, we are not in agreement. More specifically, we look to paragraph 5 of SFAS 157, which defines fair value as, “*The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction [emphasis added]** between market participants at the measurement date*”. Paragraph 8 of SFAS 157 goes on to say that, “*A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for*

¹ GNAIE is a trade organization comprised of 19 leading insurance companies including life insurers, property and casualty insurers, and reinsurers. GNAIE members include companies who are the largest global providers of insurance and substantial multi-national corporations, and all are major participants in the US markets.

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the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability". We believe that when the principal market for a financial asset becomes inactive (e.g., as determined in the Proposed FSP) and observable transactions in those markets are not orderly transactions (i.e., forced liquidations or distressed sales), the most advantageous market becomes a hypothetical market where market participants (including the reporting entity) would transact at the value determined through application of a valuation technique such as that described in the Proposed FSP.

When markets are inactive, transparent, market observable information typically does not exist to allow either reporting entities or financial statement users to adequately determine whether observed transactions are forced liquidations or distressed sales. As a result of the lack of transparency associated with observed transactions in inactive markets and the inability of both reporting entities and financial statement users to determine whether they represent transactions between willing buyers and willing sellers (or alternatively represent forced liquidations or distressed sales), we believe those transactions should not be considered determinative in the measurement of fair value.

In contrast to the preceding, we support the practical approach set forth in the Proposed FSP as it would provide superior transparency to financial statement users about the determination of fair value of financial assets associated with markets that are inactive. Superior transparency would be achieved through the clear disclosure of key assumptions, processes, and data used to derive fair value measurements using alternative valuation techniques. This compares to the complete lack of transparency into the key determinants of fair value associated with isolated transactions that occur in markets that are inactive.

We believe the Proposed FSP provides a practical and effective approach to evaluate **markets** to determine if they are active and **transactions** to determine if information exists to rebut the presumption that they are associated with distressed transactions. In situations where a transaction is determined to be associated with an inactive market and itself is determined to be a distressed transaction, the Proposed FSP directs reporting entities to use a valuation technique other than one that uses that quoted price without significant adjustment as this would not convey transparent information to financial statement users on the grounds it is typically not possible to acquire information about the motivations of buyers and sellers in inactive markets. In contrast, the application of an alternative valuation technique can be completed with the utmost transparency as it relates to key inputs that are most sensitive to the measurement.

We believe the Proposed FSP is responsive to the market's demand for additional guidance in the determination of fair value where markets are inactive. Moreover, while we understand that some constituents oppose the guidance in the Proposed FSP on the grounds it may allow excessive "management judgment" and "reduce transparency", we strongly believe the alternative (i.e., continuing to rely on "last transaction prices" in inactive markets) provides financial statement users with "no transparency" into the value of the affected financial assets, is subject to potential manipulation, and is also more representative of liquidation values as opposed to fair value that would be used to value financial assets of a going concern.

To balance the use of greater management judgment, we recognize the need for disclosures that provide sufficient "transparency" into how model input assumptions were derived, the relative sensitivity of



model inputs, as well as information about the validation of model inputs when modeled financial assets are sold or otherwise disposed of.

Notwithstanding our support for the Proposed FSP, we are concerned that certain provisions in the proposal, some of which are discussed in the attached Appendix, if interpreted literally, may cause operational challenges for reporting entities. For example, we believe confusion was created by the Board's decision not to specifically limit the scope of the Proposed FSP to *financial assets associated with markets that are inactive at the reporting date, but were previously active, and for which, there is a presumption they may become active again in the future*. We believe it would be helpful if the FASB were to specifically clarify that the Proposed FSP does not apply to *financial assets associated with markets that were never active, and for which there is no anticipation they will become active in the future*. Similarly, absent additional clarity, we are also concerned with the degree of substantiation that may be required for certain management judgments and have outlined our concerns in the attached Appendix which provides responses to questions posed by the Board concerning specific provisions of the Proposed FSP.

Responses to specific questions set forth in the Proposed FSP are provided in the attached Appendix. If the Board or Staff desires further discussion of any points contained in this cover letter or the attached Appendix we would be happy to make ourselves available.

Respectfully,

A handwritten signature in black ink that reads "Kevin Spataro". The signature is written in a cursive, slightly slanted style.

Kevin Spataro
Chairman, Accounting Convergence Committee
Group of North American Insurance Enterprises, Inc.

KS:DB:c11

Appendix

The FASB requested that constituents comment on various questions posed by the Board. GNAIE responses are as follows:

Question 1: Is the proposed effective date of interim and annual periods ending after March 15, 2009, operational?

- Given the timing of releasing the Proposed FSP and the burden it would place on reporting entities if they implement the provisions of the proposed FSP in the first quarter of 2009, GNAIE is supportive of an effective date of June 30, 2009 with early adoption encouraged. This would allow registrants that may be unable to implement due to operational reasons to implement as of June 30, 2009 as opposed to March 31, 2009.

Question 2: Will this proposed FSP meet the project's objective to improve financial reporting by addressing fair value measurement application issues identified by constituents related to determining whether a market is not active and a transaction is not distressed? Do you believe the amendments to Statement 157 in this proposed FSP are necessary, or do you believe the current requirements in Statement 157 should be retained?

- GNAIE believes that fair value, as defined in SFAS 157, is the appropriate measurement principle to apply to financial assets associated with markets that are active, liquid, and orderly. In contrast, where active, liquid, orderly markets do not exist (including situations where markets were previously active but are now inactive at the reporting date), financial assets should be valued using valuation techniques other than one that uses a quoted price without significant adjustment as described in the Proposed FSP. The Proposed FSP is considered necessary, as the guidance in FSP SFAS 157-3, which permits the use of alternative valuation techniques to value financial assets associated with inactive markets, was interpreted to require use of observable transactions, including those associated with inactive markets, in the development of inputs for the alternative valuation techniques. Accordingly, FSP SFAS 157-3 did not address constituents' concerns as it did not include guidance to identify distressed transactions to be ignored in the development of input assumptions for alternative valuation techniques.
- GNAIE believes the Proposed FSP can meet the objectives of determining the fair value of financial assets in inactive markets if certain modifications are made to the proposal. Our recommended refinements are noted in the remainder of this letter.

Question 3: Do you believe the proposed two-step model for determining whether a market is not active and a transaction is not distressed is understandable and operational? If not, please suggest alternative ways of identifying inactive markets and distressed transactions.

- GNAIE does not believe paragraphs 11 through 13 provide sufficient clarity for financial statement preparers or users. We understand the logic and interaction of paragraphs 11 and 13 as follows:
 - Paragraph 11 identifies the characteristics of an inactive market; and
 - Paragraph 13 identifies the characteristics of a distressed transaction;

- When attempting to value a financial asset by reference to an observed transaction, a reporting entity shall first determine whether the observed transaction is associated with a market that is inactive (i.e., paragraph 11) and if that is the case it shall also determine whether the observed transaction itself is a distressed transaction (i.e., paragraph 13);
 - If it is determined that an observed transaction is associated with an “inactive market” and is itself a “distressed transaction” the transaction should not be used to value a financial asset but rather the reporting entity must use a valuation technique other than one that uses the quoted price associated with the distressed transaction.
- We believe the FASB should consider simplifying paragraph 13 such that once a reporting entity concludes in step 1 that a market for a financial asset is not active, it would conclude that any observed transactions associated with that market are not orderly transactions *unless* the reporting entity has specific information to the contrary. This might be the case if the reporting entity was specifically involved in an arm’s length transaction in the subject market that would qualify as an orderly transaction.
 - In situations where the reporting entity concludes in step 1 that a market for a financial asset is not active and it has no specific information to rebut the presumption that all observed transactions associated with that market are not orderly transactions any observed transactions from that market should not be used to value a financial asset but rather the reporting entity must use a valuation technique other than one that uses the quoted price associated with a disorderly market.
 - An example of the preceding would be if a reporting entity was involved in the purchase of the security and as a result was party to an orderly transaction. This would prevent the reporting entity (i.e., acquirer) from recognizing a day one gain as a result of using a valuation technique other than one that uses a quoted price without significant adjustment as described in paragraph 15.
 - We believe additional clarity is needed regarding the level of effort expected to be involved in identifying whether the factors identified in paragraph 11 are present and how these factors should be evaluated to determine if a market is inactive or disorderly. Specific recommendations are noted in our response to Question 4.
 - Should the FASB decide to retain the two step process as provided in the Proposed FSP, GNAIE would recommend clarifying that reporting entities would not be expected to exhaust “all efforts” in identifying evidence of multiple bidders or whether there was sufficient time before the measurement date to allow usual and customary marketing activities for the asset. We believe the intent of the FASB was to eliminate the need for a reporting entity to search for evidence, rather, if they are aware of evidence existing as a result of their normal diligence efforts, this evidence should be considered.

Question 4: Are the factors listed in paragraph 11 of the FSP that indicate that a market is not active appropriate? Please provide any other factors that indicate that a market is not active.

- We believe the factors in paragraph 11 are appropriate. However, in considering the factors in paragraph 11 of the Proposed FSP, we do not believe all factors need be present to conclude that a market is inactive. Moreover, we also do not believe management should be required to evaluate *all factors* set forth in paragraph 11 as, in some cases, the existence of one factor may represent more than sufficient evidence, in management’s judgment, to conclude that a market is inactive. We believe this point should be clarified in paragraph 12 of the Proposed FSP by adding the following provision: “*After evaluating all relevant and available information regarding the characteristic factors of an active market and considering the significance of each, the reporting entity shall use its judgment in determining if a market is active.*”

Question 5: What costs do you expect to incur if the Board were to issue the proposed FSP in its current form as a final FSP? How could the Board further reduce the costs of applying the requirements of the FSP without reducing the benefits?

- While not insignificant, GNAIE generally believes the costs associated with implementing the Proposed FSP for most constituents would be outweighed by the benefits of better transparency into the valuation of financial assets associated with inactive markets.
- We believe increased clarity in certain sections of the Proposed FSP could reduce implementation costs. For example, paragraph A32D which discusses the estimation of the “most likely cash flows for a collateralized debt obligation states that,

“Entity A uses an estimate of the most likely cash flows from the collateralized debt obligation security, which were determined on the basis of a model that uses realistic assumptions (considering all available market information discussed below) about the performance of the underlying mortgage loans. The cash flows represent the most likely outcome from the range of all possible outcomes (that is, it is not the best case scenario and it is not the worst case scenario).”

We believe the use of the term “all possible outcomes” should be clarified to indicate whether or not it is meant to suggest the use of stochastic modeling would be required.

- In Example 11 of the Proposed FSP, paragraph A32E provides a list of items that may be considered when estimating the appropriate return. Included in the list is item (3) “Reasonable assumptions regarding liquidity and nonperformance (for example, default risk and collateral value risk) risks that willing buyers and sellers would consider in pricing the asset in an orderly transaction based on current market conditions.” We would recommend the Proposed FSP be modified such that item (3) excludes the phrase “...*based on current market conditions*”. We believe continuing to include this phrase may cause confusion and lead some to believe that liquidity premiums in the current market should be considered.
- Also within Example 11 of the Proposed FSP, guidance is provided in developing the appropriate discount rate. Paragraph A32F indicates a reporting entity should consider all relevant market information in determining the appropriate discount rate. The example shows the reporting entity choosing the midpoint of a range of possible returns; we believe the Proposed



FSP should be clarified to state that the rate within the range of possible range of returns should be based on management's judgment and should be supported with any relevant information.