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Executive Director

February 12, 2009

To the Co-Chairs of the Financial Crisis Advisory Group

Mr. Harvey Goldschmid

Mr. Hans Hoogervorst, Chairman

Netherlands Authority for the Financial Markets (AFM)

copies to: Mr. Robert H. Herz, Chair, Financial Accounting Standards Board (FASB)
Sir David Tweedie, Chair, International Accounting Standards Board (IASB)
Mr. Jeffrey D. Mechanick, Project Manager, (FASB)

Gentlemen:

The Group of North American Insurance Enterprises (GNAIE) consists of leading insurance companies including life insurers, property and casualty (“non-life”) insurers, and reinsurers. GNAIE members include companies who are among the largest global providers of insurance and substantial multi-national corporations. We are writing today to provide input to the IASB/FASB Financial Crisis Advisory Group (FCAG) as it continues its discussions concerning the recent events in world financial markets. We’ve taken the opportunity to provide responses to the questions listed in the agenda material in the hope they will prove useful to you.

At whom should general purpose financial statements be primarily aimed and why? Should general purpose financial statements have a financial stability objective? Why or why not?

A general purpose standard *should* have a financial stability objective. There will often be more than one way to fulfill investor needs for information, and whether one or another is optimal will frequently be a subjective assessment, or the result of an incremental difference. At the same time accounting standards affect the behavior of preparers, investors and regulators, and the trends of those behaviors can have very significant affects on economic health and financial stability. Ill effects on financial stability will also damage investors directly and the economy in general.

The incrementally or theoretically “best” accounting standard for investors might engender behaviors on the part of preparers or investors that create systemic risks. A different standard that provides sufficient information to investors, but is more supportive of economic health and financial stability ought to receive very serious consideration. Hierarchies of decision criteria can be complex, and support of

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financial stability and the needs of all stakeholders ought to be among the considerations placed into balance with the needs of investors.

“Fair value” (FV) as defined in the standards has become heavily model-driven, often at the detriment of judgmental considerations of what actually constitutes “fair value”. The implication that “fair value” information (as defined in the standards currently) is not biased is unsupported. It is biased toward the assumptions that:

- Only the most recent market price information is financially or economically relevant to the user;
- Short-term market fluctuations are relevant to the going-concern value of the entity;
- The holder’s intent (other than choice of exit market) has no impact on the economics of the balance sheet item;
- A hypothetical exit value is relevant in the absence of a functioning market¹.

These are issues that are not solely related to whether the accounting standards support financial stability. They are also issues as to whether the accounting standards are relevant, representationally faithful, understandable, etc. Pro-cyclicality may not only be an issue of concern with regard to financial stability. Pro-cyclicality may also be a symptom of the valuation standard’s undue sensitivity to short-term value changes that are not materially relevant to the economics of the reporting entity, when the economics are assessed using principled judgment.

With specific reference to fair value, should financial stability or pro-cyclicality be considered even if a loss of transparency of information would result?

There is no reason why provisions of the accounting standards put into place to dampen pro-cyclicality need to impair the transparency of information. Pro-cyclicality is (primarily) engendered by changes in market values affecting capital or income. The threat that future market drops will deteriorate the capital or income of the entity cause management to overreact to unsubstantiated information or short-term incremental price declines. A disclosure of un-adjusted fair value information that did not immediately run through profit and loss or would be a supplemental balance sheet disclosure would give the analyst the tools necessary to assess the values reported according to other bases, and have far less pro-cyclical effect.

The relevant question is whether a FV standard that requires a hypothetical, model-driven exit value

¹ Absent any guidance re-directing the valuation from FAS 157 in that case.

when no functioning market exists should be the sole basis of balance sheet and income reporting.

What principles should determine when financial instruments are carried at fair value and when changes in fair value should be included in profit or loss (earnings)?

Fair value, as defined in FAS 157, objectively represents the intrinsic value of a balance sheet item when an active, liquid, and orderly market exists. In the absence of an active, liquid, and orderly market, fair value tends to represent liquidation values that are not appropriate for financial statements presented on a going concern basis. Some analysts find disclosure of fair value information in disorderly circumstances useful, and we have no objection to presenting such information either as a supplement, or as disaggregated changes to other comprehensive income.

Intrinsic value can be defined in terms of the purpose of financial statements: the present value of the probable impact of the balance sheet items on the income of the entity reporting. The enhancing qualitative characteristics and constraints (verifiability, cost/benefit, etc.) should also inform decisions regarding the appropriate measurement basis.

What additional guidance, if any, is needed in the area of determining fair value?

The FV guidance releases by the FASB, IASB the IASB Expert Advisory Panel (EAP) and the SEC have failed to resolve the key issue of the role of infrequent transactions in inactive, illiquid and disorderly markets in estimating a hypothetical transaction price.

In addition a serious discussion needs to be held with constituents as to the performance of FV, particularly as defined in FAS 157, in this crisis. There has been little if any discussion on whether a hypothetical exit price is relevant, reliable or comparable in inactive, illiquid and disorderly markets, and what alternatives exist. The phrasing of this question avoids the issue.

We strongly suggest a quantitative study of the performance of FV measurements both before and after the crisis compared to actual cash flows and ultimate impact on the entities affected by the crisis. Alternatives should be studied as well.

As an example of an alternative, we continue to support our proposal for structured credit products, which we have presented in numerous comments and discussions. There should be a screen in FAS 157 to redirect the accounting for securitizations whose market becomes inactive, illiquid and disorderly from "fair value" to the accounting basis for the underlying assets.

With regard to "dynamic provisioning", valuation on a "through the cycle", portfolio basis sounds attractive (and familiar to insurance companies). We look forward to participating in further discussions to achieve an operational proposal. We do not believe that technical questions concerning implementation of the idea should preclude discussion of "dynamic provisioning" or any other



alternative to fair value. We feel that standard setters should undertake good faith efforts to answer the questions raised in the course of evaluating the appropriateness of the concept. In addition, we are concerned that requiring pro-cyclicality be addressed entirely by sector regulators may in the end increase the pressures for regulatory arbitrage.

Thank you for considering our comments. We will be listening with great interest to your call tomorrow. Unfortunately, I will not be able to attend, but GNAIE will be represented at the meeting by its Executive Director, Doug Barnert.

Please let me know if you have any questions or need additional information.

Sincerely,

A handwritten signature in black ink that reads "Jerry de St. Paer". The signature is written in a cursive, flowing style.

Jerry de St. Paer
Executive Chairman

JdSP:wes