



Letter of Comment No: 37

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Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116

September 6, 2004

Dear Ms. Bielstein:

Exposure Draft (ED or Proposal) on the Proposed Statement of Financial Accounting Standards, Fair Value Measurements

File Reference No. 1201-100

XL Capital Ltd (XL, we or our) would like to thank you for the opportunity to comment on the Exposure Draft on the Proposed Statement of Financial Accounting Standards, Fair Value Measurements. We support the Financial Accounting Standards Board (FASB or Board) objectives to provide guidance for the measurement of financial and non-financial assets and liabilities that are required to be measured at fair value under other authoritative accounting pronouncements.

XL is a member of the Group of North American Insurance Enterprises ("GNAIE") and support all of the views expressed in the separate comment letter submitted by GNAIE.

Our responses to the specific questions raised by the FASB are attached in Appendix A. We would be pleased to discuss any of these issues with you in detail if this would be helpful. You may contact me on (441) 294-7382.

Yours sincerely,

Derrick A. Irby
VP, Accounting Policy Officer

cc: Jerry de St. Paer, EVP & Chief Financial Officer
Joseph C. Henry, SVP Finance
Michael A. Siese, SVP & Controller
Jenny Ross, VP Accounting Research, Europe

Appendix A

Issue 1: Definition of Fair Value

We believe that each company will be able to consistently apply the fair value measurement objective for their financial instruments using the guidance provided by this proposed statement provided that management is allowed to develop their own implementation guidelines. However, we do not believe that the guidance can be consistently applied among all entities because of the significant areas of judgment required and the varying views among companies with respect to market conditions and an instrument's embedded value.

The proposal requires management to use judgment with respect to (1) whether a market is active and the data is readily and regularly available, (2) which valuation method (market, income or cost approach) is appropriate and (3) which assumptions to use or "adjustments" to make within its valuation model. Other areas of significant judgment may be applicable depending on the nature of the financial instrument.

We support this "principals-based" accounting approach prescribed by the FASB. However, in practice, the accounting firms often develop their own "rules-based" guidance which companies must comply with in order to receive an unqualified audit opinion. This may result in companies having to follow rules prescribed by the audit firms without consideration of reasonable arguments presented by management. Unfortunately, this is often the result with respect to areas requiring estimation techniques and management judgment. As a result, these principals turn into rules and diversity in practice remains an unresolved issue because each accounting firm has their own set of rules which they deem acceptable. We believe that management is in the best position to make these determinations as long as their policies are reasonable, consistently applied and reflect the economic reality of the instrument.

We recommend that the FASB explicitly state that companies should establish their own policies with respect to whether a particular market is active, the appropriate valuation level (i.e. Levels 1-3), and the other substantive provisions of the statement. This will ensure consistent application of the guidance among the different types of transactions requiring fair value measurement that a company enters into.

Issue 2: Valuation Techniques

We have no comment.

Issue 3: Active Markets

As noted in our response to issue #1, we support this principals-based approach provided that companies are allowed to define which markets are deemed active. If this is not the intent of the FASB, then they should prescribe clear implementation guidance (i.e. the number of transactions per day, week, month, etc. that make an active market).

Issue 4: Valuation Premise

We have no comment.

Issue 5: Fair Value Hierarchy

We recommend that the FASB provide clear guidance regarding the use of “adjustments” in Levels 2 and 3 estimates in the fair value hierarchy. Specifically, the passage of time and changes in market conditions may have an impact on the fair value of an asset that trades in a market where monthly or quarterly prices are not available. In this case, adjustments to the price of a similar asset may be appropriate. However, the guidance provided will not ensure consistent use of adjustments by all companies.

Issue 6: Level 1 Reference Market

We have no comment.

Issue 7: Pricing in active dealer markets

We do not support the requirement to use bid and ask prices to determine the fair value of financial instruments. Bid and ask information is not always available in a dealer market, in which case fair value will need to be estimated using the adjusted prices of similar instruments or valuation techniques with bid and ask prices acting as the maximum and minimum limits for an estimate. Some companies receive only a single price feed, based on the last traded price at the close of business to value trading assets, rather than a bid/ask spread. The proposed requirement may require companies to incur additional costs and system changes to be able to obtain the bid/ask spread. Management, with the assistance of their investment managers and consultants, should be allowed to determine which price is the most appropriate measure of fair value based on the specific facts and circumstances regarding the financial instrument.

In the event that the FASB proceeds with this requirement, they should consider amending the effective date to allow companies to determine the extent of systems changes required by their investment department and those of their external managers and consultants.

Issue 8: Measurement of blocks

We have no comment.

Issue 9: Estimates

We believe that clearer guidance should be given with respect to the use of multiple valuation techniques for a Level 3 estimate. It is not clear whether the use of at least two valuation techniques are required in for management to be deemed to have used a reasonable basis for determining fair value. If management feels strongly that the valuation technique used for a Level 3 measurement is the appropriate technique, are they required to use another technique as a reasonableness test if there is no undue cost and effort? If so, clear guidance should be given with respect to the definition of undue cost and effort. Also, refer to issue 2 and 3 above.

Issue 10: Restricted securities

We have no specific comments. Please refer to the concerns noted in Issue 5 regarding “adjustments”.

Issue 11: Fair Value Disclosures

We note the Board's acknowledgement that financial institutions already provide most of the disclosure requirements proposed in this statement. As such, we are concerned with the amount of duplication between the MD&A and the notes to the financial statements that will result from implementation of the proposed disclosure requirements. We would like the Board to reconsider whether SEC registrants should be required to duplicate these disclosures in the notes to the financial statements.

With respect to the disclosures that are not currently required, there will likely be significant implementation issues for all companies. It is probable that the users of the financial statements including the analyst community, rating agencies and possibly regulators may naturally expect companies to provide information on earlier years for comparability and trend analysis. This would be extremely onerous for companies to achieve given the strain on resources from Sarbanes-Oxley Act compliance efforts and accelerated financial reporting deadlines mandated by the SEC.

The Board should consider conducting further research in order to determine whether the proposed fair value disclosure requirements provide meaningful information to investors when considering the additional implementation cost and effort.

Issue 12: Effective Date

We do not support the proposed effective date for financial statements issued for fiscal years beginning after 15 June 2005 and interim periods. We do not believe that the proposed effective date will provide companies with sufficient time to implement the proposed requirements included in this exposure draft. Accordingly, we recommend that the effective date be extended. Also, refer to our response to Issue 7.

Issue 13: Other Issues

We recognize that the proposed statement applies to assets and liabilities currently measured at fair value under other pronouncements, but feel that it is important to note our concerns should insurance companies be mandated to apply the fair value methodology to insurance contracts. Our concerns are escalated by the IASB's recent developments on the proposed amendments to IAS 39 "Fair Value Option" and the comparable project called "Elective Fair Value of Financial Instruments" initiated by the FASB.

Whilst we support the FASB decision to develop consistent fair value measurement guidelines, we are concerned that any future FASB proposals resulting from the IASB's work on the joint modified approach for insurance contracts will not reflect the economic and commercial realities of our business. We consider that a key issue is how to estimate market values for insurance assets or liabilities that do not have deep and liquid secondary markets. Insurance contracts are unique due to the fact that certain insurance obligations are long-term, insurance risks are difficult to forecast and insurance provides risk diversification benefits. When considering the regulatory restrictions that apply to most insurance contracts, it is clear that the definition of fair value is not operational for insurers. Insurers are not able to exit an insurance contract and be completely exonerated from liability without the consent of the policyholder. Accordingly, there exists no active market to verify such an exit price.



Finally, we understand that the FASB's "Elective Fair Value Option of Financial Instruments" project will only allow fair value recognition for certain assets and liabilities. We believe that the FASB should explicitly exempt insurance contracts from the scope of this project for the reasons noted above and those noted in the letter issued by GNAIE.

Issue 14: Public Roundtable Meeting

Assuming that we have the resource available and diary availability, we would welcome attendance at such a roundtable meeting.