



Letter of Comment No: 201
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Mr. Lawrence W. Smith, Director
Technical Application and Implementation Activities
Financial Accounting Standards Board
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RE: Comments on FASB Staff Position EITF Issue 03-1 a

Dear Mr. Smith:

Thank you for the opportunity to comment on the FASB Staff Position clarifying *EITF Issue 03-1-a The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. We support the Board's effort to clarify EITF 03-1 (EITF), however we do not believe that the changes are substantial enough for insurance companies. It is important that the clarification of the EITF focus on credit related risk, rather than all Available For Sale assets trading below book value. Price declines caused solely by interest rate changes or credit sector spread changes should not be considered other-than-temporary impairments. We believe economic loss for a company only occurs when debtors cannot repay their debt as contractually obligated. This is where the focus of the EITF should be. The current EITF and FSP will produce financial statements that do not represent the economics of the situation and will produce less valuable and comparable information.

Insurance companies have extensive asset/liability risk management frameworks to ensure that liquid assets will be available when payments are estimated to be made to policyholders and that the assets selected add substantial value for shareholders. These models are subject to frequent, but generally marginal, rebalancing. If a company has a proper asset/liability match (ALM), these rebalancings result primarily in substitutions of one asset for another. Insurance companies are one of the largest holders of publicly traded corporate debt and most companies of medium to large size have built their own credit departments and risk management areas to properly implement ALM. Effective ALM practices require continuous reassessment of risk/reward as the market changes and result in a moderate level of asset sales and purchases. These risk management practices also result in substitutions of one asset for another. These substitutions of assets do not

result in economic loss for the company, but rather add value by optimizing risk/reward and better position the company for payment of anticipated future claims from policyholders. Examples of these trades include:

- Asset exchanges done to match liabilities when the duration of those liabilities changes due to interest rate movements.
- The credit department assesses two securities to have the same level of risk (example: two AA rated bonds), but the one that is owned by the company trades at a higher price than the other. This results in the disposition of one security and the purchase of a lower priced asset.
- Sector rebalancing done for risk management purposes in which the risk in one sector is judged to be slightly better than another sector, both of which the company has large exposure to. This results in a relatively small amount of assets being sold and replaced by others in the sector with better risk characteristics.

The current accounting guidance contained within the EITF and the FSP would require a company to choose from these options:

- Option one: Recognize all unrealized losses through the income statement instead of other comprehensive income (OCI) for the entire bond portfolio in order to preserve the right to trade some portion for ALM/Risk Management purposes. Changes due solely to interest rates can result in billions of dollar swings in asset values from period to period producing volatility in earnings where there is no economic change.
- Option two: Cease portfolio trades and reduce the effectiveness of ALM/Risk Management practices causing erosion of shareholder value.
- Option three: Designate new purchases as “trading” securities so that both gains and losses can be recognized over time.

All of these options are sub-optimal and degrade the meaning of the financial statements, making it difficult to compare one company to another. If all unrealized losses are recognized through the income statement by a company that trades a minority of its portfolio and another company recognizes no losses because it has a less disciplined ALM process, it would appear to an investor that the first company is in worse financial condition when they arguably have done a better job managing the company. Additionally, all the work that companies do today to evaluate securities to determine if it is probable that a debtor will not repay principal and interest will be lost as it will be combined with noneconomic losses. The disclosures on impairment losses today focus on issuer specific problems, and we believe that to be very important information to analysts. The EITF will change these disclosures to be focused primarily on interest rates. Additionally, the company that records a large volume of interest rate impairments will have higher investment income in future periods as they accrete this discount back into earnings over the life of the security. This is theoretically correct, but makes comparability between companies difficult.

We do not believe that becoming less disciplined in our ALM practices in order to reduce investment trades is an appropriate or viable approach for our company. The third option, designating securities as trading, has many of the same downfalls as option one. It makes comparability of financial statements difficult, it buries credit losses, and since it is an adjustment to income that does not reflect economic loss this will largely be ignored by the investment community and significant supplemental disclosure will be required.

Recommendation

We believe that the focus of impairment for debt securities should be on issuer credit problems, not on interest rates or changes in sector spreads. We would recommend that the current EITF be amended to apply only to equity securities. A new model should be developed for debt securities. This would require a principle to be established to determine when an other-than-temporary impairment should be taken for debt securities. This principle should result in loss recognition only when it is probable that the debt holder will suffer an economic loss. The principle should not establish premature loss recognition solely for the purpose of preserving a right to sell a security in a future period, if it is probable that a debtor will be able to pay its contractual obligation. A modified lower of cost or lowest historical market value paradigm is not an ideal accounting model because it realizes losses but ignores gains, as the Board recognized when it authored FAS115 (paragraph 27b). It also seems to conflict with FASB Concepts Statement 2 by using excessive conservatism in current financial statements that may lead to overstatement of income in future periods.

The concept of intent and ability to hold on a security by security basis is contrary to a disciplined ALM and risk management process, which we consider to be a very prudent and responsible practice in the insurance industry. Although the concept of intent and ability to hold was introduced in SAB 59, which was initially written for equity securities, it later carried over to debt securities as one of several indicators of impairment. SAB 59 provides other indicators of impairment such as the length of time and extent to which the security's market value has been less than its cost. In practice, SAB 59 has been applied to debt securities, but the intent and ability to hold assertion has been made only on those securities that have been in an unrealized loss position by a significant amount for more than six months (i.e., focusing primarily on credit issues). The EITF extends the requirement of this assertion to all assets that are in an unrealized loss position, not just those due to credit issues.

If the Board is not inclined to develop a separate model for debt securities, we believe a viable alternative approach would be to revise paragraph 16 in EITF 03-1. Paragraph 8b. speaks to indicators of impairment which focus primarily on issuer specific credit issues. Our recommendation would be to change paragraph 16 such that a company must assert its intent and ability to hold for securities that have specific issuer credit concerns. For securities that are in an unrealized loss position solely due to interest rates or sector spread movements, the assertion would be that a company has no plans to sell the security (consistent with guidance provided in Topic D44). Additionally, debt securities covered in paragraph 10 should be encompassed in paragraph 16, as well. Because of the coverage of

these securities in EITF 99-20, which adequately deals with impairment, we do not believe that they need to follow the same criteria as equity securities. Paragraph 16 could be changed as follows:

16. For debt securities, an impairment should be deemed other than temporary if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the debt security. In making the determination about collectibility, the investor should consider all information available about fair value fluctuations due to factors other than interest rates and general sector spreads. These include:

- A significant deterioration in the earnings performance, asset quality or business prospects of the investee
- A significant adverse change in the regulatory, economic, or technological environment of the investee
- A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates
- A bona fide offer to purchase (whether solicited or unsolicited), an offer by the investee to sell, or a completed auction process for the same or similar security for an amount less than the cost of the investment
- Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants
- Significant deterioration in credit ratings, such as a downgrade from investment grade to non-investment grade or other significant deterioration within the non-investment grade rating classification

Price declines caused solely due to interest rate changes and overall sector spread movements should not generally be a cause for impairment, unless the investor plans to sell the security. To the extent a security is in an unrealized loss position for specific creditor issues (i.e., other than general interest rate movements or when the security's credit spread widens significantly beyond the sector credit spread), the investor must also have the ability and intent to hold an investment until a forecasted recovery of fair value up to (or beyond) the cost of the investment or the impairment should be considered other than temporary.

This would also require the example in Exhibit 03-1C to be modified to be consistent with these wording changes.

Additionally, the minor impairment as discussed in paragraph 5 of the FSP should acknowledge that a company could consider the security type and duration, and therefore the threshold for minor may be different on a security by security basis.

Conclusion

Insurance companies need to trade assets to prudently manage portfolio risks and optimize shareholder value. It is unreasonable to identify assets today that will be traded in the future. Prudent companies will not restrict themselves from future trading and hence will be forced into a modified lower of cost or lowest historical market value paradigm. Clearly this will lead to far less meaningful financial statements. We strongly request that new guidance be created for debt securities that focuses on issuer specific credit concerns surrounding the ability of debtors to repay their debt as contractually obligated. We believe that current disclosures for debt securities in an unrealized loss position for other than credit related reasons provide adequate data to investors.

We appreciate the opportunity to provide feedback and the time you have taken to consider our concerns. We offer our support to answer any questions you may have.

Sincerely,



Brenda Clancy

**Treasurer, Executive Vice President – Information and Finance
AEGON USA, Inc.**