



CNA Plaza Chicago, IL 60685-0001

Letter of Comment No: 197  
File Reference: EITF03-1A

**Lawrence J. Boysen**  
*Sr. Vice President & Corporate  
Controller acting Chief  
Financial Officer*  
Telephone 312-822-5653  
Facsimile 312-817-1755  
Internet  
*Lawrence.Boysen@cna.*  
com

October 29, 2004

Mr. Robert H. Herz  
Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, Connecticut 06856-5116

Mr. Lawrence W. Smith  
Chairman of Emerging Issues Task Force  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, Connecticut 06856-5116

File Reference – FSP 03-1-a Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments”

Dear Mr. Herz and Mr. Smith:

Thank you for the opportunity to provide comments on FSP EITF 03-1a. We would also like to emphasize a few issues that we feel need some additional focus. Our response will first give an overall perspective on CNA’s investment environment, followed by brief summaries of the issues we feel need to be addressed and finally the responses to the FSP. Additional general observations follow at the end.

CNA is the country’s seventh largest commercial insurance writer and 14<sup>th</sup> largest property and casualty company. CNA’s insurance products include standard commercial lines, specialty lines, surety, marine and other property and casualty coverages. CNA’s invested assets exceed \$36 billion. Management of an investment portfolio of this size involves consideration of many variables that are constantly changing. Because of these dynamics, the Company categorizes the majority of its investments within the available for sale (AFS) designation under SFAS No.115 “Accounting for Certain Investments in Debt and Equity Securities” (FAS 115). In choosing this designation, the Company recognizes that it may from time to time sell securities in a loss position not solely due to outlook on recoverability but due to various other considerations. Key amongst these are asset liability management, liquidity needs or portfolio rebalancing activities necessary to comply with our risk management guidelines.

CNA has a mix of insurance business that includes expected claim payments ranging over many years in the future. Because of this, the Company manages much of the portfolio based on durations that align to these liabilities in order to effectively manage the underlying cash flow and related interest rate risks. In addition, the Company actively manages the investment portfolio to comply with applicable state insurance regulations. For example, New York Regulation 126 cashflow testing requires testing asset and liability cash flows under multiple interest rate scenarios. Portfolios subject to this regulation are managed in order to pass cashflow testing, reduce disintermediation risk and avoid unnecessary reserve increases.

In order to continue to maintain the flexibility necessary to prudently manage our investment portfolios, we feel that the following areas of EITF 03-1 need additional clarification or guidance:

**Paragraph 10 versus paragraph 16** – there has already been conflicting interpretations on how to apply paragraph 10 related to debt securities. We believe there needs to be some clarifying language or some additional examples as to what qualify as paragraph 10 debt securities. Specifically, is the focus of paragraph 10 strictly on the contractual ability of the issuer to prepay a security, or was it the staff's intent for practice to interpret the terms of the call in order to determine when to apply 10 or 16? We believe, based on the limited examples given in EITF 03-1, the intent was to use judgment in practice on the application of this paragraph. We intend to interpret this guidance to focus on contractual call provisions on debt securities and mortgage backed securities carried at a substantial premium. Furthermore, we feel that the prepay event must be within a reasonable number of months from the date the security is being analyzed for impairment to have a bearing on the likelihood of the issuer to exercise the call.

The wording used in the FSP questions 3a and 3b makes reference to "interest-rate-impaired and/or sector-spread-impaired securities" and has generated some concerns. This language was not used in either paragraph 10 or 16 of the EITF and may cause interpretation issues where additional examples may be required.

**One time transfer to trading designation** – we believe that the impact of the EITF is material and justifies a one time transfer of securities from AFS to Trading. The guidance in SFAS 115 says that transfers of this type should be rare and in practice this has been narrowly interpreted. Depending on the outcome of the FSP, many companies may elect to adopt full mark to market accounting rather than the one sided lower of cost or market (LOCOM) impact that will result.

Following are our specific responses to the issues and questions within FSP EITF 03-1a:

## **REQUESTS FOR COMMENTS**

### **Minor Impairments**

*Issue 1:* We believe that there should not be a bright line established to apply the notion of "minor impairment" from the FASB. In keeping with FASB's desire to promote principles based guidance, it should remain up to management's judgment within the principles of EITF 03-1 to apply this notion. A statement of underlying principles on which the EITF is based would be helpful in establishing rules to be used in practice. Although some principles were discussed in the drafting proceedings, there were none stated in the final guidance. Stating the guiding principles and letting the profession apply these may avoid additional rules based guidance.

### **Limiting the Notion of Minor Impairments to Debt Securities Evaluated for Impairment Pursuant to Paragraph 16 of Issue 03-1**

*Issue 2:* We do not support the Board's conclusion to limit the notion of "minor impairments" to just paragraph 16 securities and urge that this notion be applied to all securities being analyzed for impairment. The disclosure guidance that was left in effect in EITF 03-1 and other disclosures required for AFS securities will be sufficient to provide transparency for the reader of the financials to make judgments on management's ability to apply this notion.

**Proposed FASB Staff Position No. EITF Issue 03-1-a**

**Question 1: At what unit of account should an investor assert its ability and intent to hold to a forecasted recovery?**

The Company does not concur with the staff positions that the assertion should be at the security level. Our investment records are maintained at the purchase lot level and sales are generally applied on a FIFO basis. We believe the assertion should be at the lowest level records are kept in a particular industry. A sale of a specific lot of a security may or may not impact a lot that is impaired. Additional guidance is necessary for those companies like ours that record and track securities at the purchase lot level.

Following is a specific example of this point:

The following purchases of XYZ company stock were acquired and held at 9/30/04

Purchase Date	Shares held	Purchase Price	Cost/Book Value	9/30/04 Market \$60.00/sh	Unrealized Gain/Loss	Length of time in unrealized loss	Other than Temporary Impairment
9/15/02	10	70	700	600	(100)	> 24 months	(100)
9/15/03	10	75	750	600	(150)	12 – 24 months	(150)
3/15/04	20	70	1,400	1,200	(200)	6 – 12 months	(200)
6/15/04	10	65	650	600	(50)	3 – 6 months	(50)
7/15/04	20	55	1,100	1,200	100	0 – 3 months	100
Totals	70	65.7	4,600	4,200	(400)		(400)

In this example, the impairment is determined to be other than temporary. The question is, should the impairment be recorded at the security level or only on those lots in a loss position? If we are to assume that the guidance is at the security level, as the intent assertion implies, then the 7/15/04 lot held at a gain would be written up to market. We currently complete the impairment analysis at the lot level and analyze each lot on its own merits.

**Question 2: Although Issue 03-1 states that an investment is impaired if the fair value of the investment is less than its cost, paragraph 16 does not refer to the severity of the impairment. Is there a level of impairment that can be considered temporary that would not create the need for an assertion about the ability and intent to hold an investment until forecasted recovery?**

The Company concurs with the staff position that there is a level of impairment to be considered temporary and believes that the term "minor impairment" should not be limited to a bright line test. We believe that the threshold for minor should take into account the change in value of the security relative to the characteristics of the security. We support an approach along the lines of the qualitative approach discussed in the September 8, 2004 Board meeting which considers the maturity of debt securities. We would suggest, for each specific debt security, to define other than minor impairment as:

The greater of 5% OR years to maturity expressed as a % not to exceed 15%. This would allow for the effect of expected interest rate and credit spread changes over time. Generally speaking, a formula of this type would accommodate the price change of most coupon bearing debt securities resulting from a 1% change in interest rates.

We further encourage that this same concept be applied to paragraph 10 securities as these securities also are subject to temporary market fluctuations caused by changes in interest rates.

**Question 3(a): If an interest-rate-impaired and/or sector-spread-impaired security for which the investor previously has asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, when is the impairment considered other than temporary?**

The Company agrees with the staff position that the impairment is considered other than temporary when the assertion to hold to recovery changes. However, the staff needs to clarify the application of this guidance. If, within the same quarterly reporting period, a company changes its assertion to hold and sells a security at a loss, is the Company expected to recognize that loss as an impairment or as a loss on sale subject to disclosure requirements. Taken literally, most losses from sales activity would be reported as impairment losses. This will interfere with the financial statement readers ability to assess investment portfolio activity. If the notion of minor impairment is determined to apply to paragraph 10 securities, then this guidance will also need to encompass paragraph 10.

**Question 3(b) If an interest-rate-impaired and/or sector-spread-impaired security for which the investor previously has asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, are there circumstances for such a change in ability or intent that would not necessarily call into question the investor's ability or intent to hold to recovery?**

Limiting the allowable circumstance for change in intent to those applicable to held to maturity (HTM) securities under FAS 115 and the additions proposed in this FSP limits prudent management of an AFS portfolio that was intended under FAS 115. The EITF appears to have unintentionally altered the guidance in FAS 115 for AFS securities in that it has applied criteria that was intended for the held to maturity category to acceptable changes in circumstances to avoid tainting a hold assertion. The AFS category in FAS 115 was intended to provide an amount of flexibility in portfolio management that has now been restricted under EITF 03-1. If this was the intent, we believe that FAS 115 should be amended and exposed, in due course, for commentary.

We do agree with any expansion of the circumstances for such a change in ability or intent listed in the FSP and we also agree that sales of other securities for which an assertion was not stated do not call into question prior assertions made. Additionally, this same guidance afforded paragraph 16 securities that allow for changes in circumstances that justify changing an assertion should also be applicable to paragraph 10 securities. Many of these same circumstances occur that necessitate a sale of paragraph 10 securities that a company may have intended to hold to recovery and made an assertion on. Companies previously did not have to manage securities within a portfolio differently based on the paragraph 10 vs 16 categories within EITF 03-1. If the same amount of flexibility afforded in paragraph 16 is not extended to paragraph 10 the ability to prudently manage securities that fall under 10 would be significantly reduced. We encourage the staff to grant this expansion to paragraph 10.

As indicated earlier, with respect to insurance companies which regularly utilize asset liability management techniques, securities may regularly be sold in the normal course of business. This may involve the sale of securities where an assertion to hold was previously made. Taking away the ability to respond to changes in circumstance not limited to a specific set listed in the EITF will result in forcing an impairment to be recognized. The end result is lower of cost or market accounting which FAS 115 specifically intended to eliminate.

In addition to the areas within EITF 03-1 of concern that we highlighted in the beginning of this letter, we would like point out a few other general observations.

#### **Principles based guidance**

To potentially avoid further rules based interpretations, many of the issues that have surfaced may be resolved by stating within the guidance the underlying principle that the staff is promoting.

The Company supports the principle discussed at the March 20, 2003 meeting of the Task Force for Step 2 of the proposed guidance: "an impairment should be deemed other than temporary unless positive evidence indicating that an investment's carrying amount is recoverable within a reasonable period of time outweighs negative evidence to the contrary." Further, at the July 31, 2003 EITF meeting, the Task Force discussed separate impairment models proposed by the FASB staff. The Task Force agreed on the general principle that impairment due to deterioration in credit that result in a conclusion that non-collection is probable should be considered other than temporary.

#### **Disclosure rules are sufficient for transparency**

We fully support these principles for impairment and encourage the staff to focus the guidance on a set of principles and allow companies to continue exercising judgments within constraints of guidance formerly provided in FAS 115 and the 115 Q&A appendix B. Absent a principles based approach this guidance will continue to raise more questions than it answers. We further believe that principles based guidance in addition to the disclosure rules in EITF 03-1 provide an amount of transparency that allows the reader of financial statements to make judgments on managements decisions on recognizing impairments. The disclosure requirements are self policing in that they require each company to explain the circumstances behind each security sold.

#### **FAS 115 AFS guidance**

We support and continue to follow the guidance from FAS 115 that if an investor does not have the intent to hold an impaired investment until recovery then an impairment should be recognized. EITF 03-1 paragraph 16 guidance states that an impairment should be deemed other-than-temporary if the investor does not have the intent and ability to hold the investment until a forecasted recovery. It also states that although not presumptive, a pattern of selling investment prior to the forecasted recovery of fair value may call into question the investors intent.

The Company believes that the AFS category within FAS 115 may have been unintentionally altered by the intent and tainting guidance within EITF 03-1 paragraph 16. The response to Question 3b of FSP 03-1a that directs companies to follow FAS 115 paragraph 8 – 11 for allowable change in circumstances appears inconsistent with FAS 115 in the following areas:

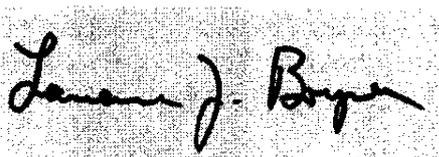
Paragraph 9 of FAS 115 establishes that reasons for selling securities that would be inconsistent with the held-to-maturity (HTM) category to include:

- a. *Changes in market interest rates and related changes in the security's prepayment risk*
- b. *Needs for liquidity (for example, due to the withdrawal of deposits, increased demand for loans, surrender of insurance policies, or payment of insurance claims)*
- c. *Changes in the availability of and the yield on alternative investments*
- d. *Changes in funding sources and terms*
- e. *Changes in foreign currency risk.*

It appears inconsistent to then allow these as acceptable reasons to change a hold assertion on a AFS security under EITF 03-1. This guidance appears somewhat circular and contradictory.

If the Company is required under EITF 03-1 to apply the strict rules based intent definition from the HTM category to AFS securities trading below cost to justify a change in circumstances it most likely would not be able to make a hold assertion. This will result in losses to be realized on most of its securities that are in a temporary loss position. We will then be restrained from making prudent trading decisions as we are subject to LOCOM accounting by recognizing only the losses which is the issue FAS 115 attempted to deter. It is difficult for companies to project future market conditions or the amount of assets that will be sold in reaction to these conditions. In order to effectively manage our business we need to continually assure that our investments are performing to meet the contractual provisions on which our policies are written and our policyholders rely. This is not possible if these same assets require a hold assertion to avoid LOCOM accounting treatment.

Thank you for consideration of these comments. Please feel free to contact me if you would like to discuss any of these issues.

A handwritten signature in black ink, appearing to read "Lawrence J. Boysen", is written over a light gray, textured rectangular background.

Lawrence J. Boysen  
Sr. Vice President & Corporate Controller  
acting Chief Financial Officer