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August 28, 2002

Via Electronic Mail

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

Letter of Comment No: 27
File Reference: 1082-200
Date Received: 08/28/02

RE: Comments on Proposed Interpretation Consolidation of Certain Special Purpose Entities
(File Ref. #1082-200)

Dear Ms. Bielstein:

The Reinsurance Association of America is pleased to provide the following comments on the FASB Exposure Draft entitled Proposed Interpretation - Consolidation of Certain Special Purpose Entities issued June 28, 2002.

The Reinsurance Association of America (RAA) is a U.S. national trade association representing 21 property and casualty organizations that specialize in reinsurance. The RAA membership is diverse, including large and small, broker and direct, U.S. companies and subsidiaries of foreign companies. Together, RAA members write more than 75% of the reinsurance written by U.S. property casualty reinsurers on business ceded by U.S. insurers.

The RAA supports the FASB's objectives of improving the financial reporting of special purpose entities (SPE's) by providing more comprehensive guidance with respect to the consolidation of these entities by business enterprises with a controlling financial interest. We believe that the proposed interpretation will achieve more consistent application of consolidation policies with respect to such entities and thus will improve financial statement comparability among business engaged in similar activities.

Our comments are general in nature and reflect the view that the proposed interpretation is a reasonable first step, but that it should provide more specific guidance with respect to liability-based SPE's such as Special Purpose Reinsurance Vehicles (SPRV's) used to securitize insurance risk. In our reading of the exposure draft we noted that the introduction specifically mentions SPE's a means of facilitating reinsurance transactions. However, the guidance for consolidation criteria based on either voting or variable interests appears have been developed primarily with asset-based securitizations in mind. Indeed, the examples address a number of varied issues, but none address liability based SPE transactions. We believe that SPRV transactions differ significantly from asset-based securitizations and that while similar principles as set forth in the exposure draft should apply to these transactions, more specific guidance is necessary.

Following is a very simplified description of an SPRV transaction. To date, virtually all of these transactions have involved the securitization of catastrophe insurance risk. SPRV transactions typically involve an offshore SPE and related trust that receives premium from a ceding insurer

and receives principal investment from capital markets investors. In exchange for the reinsurance premium, the ceding insurer enters into a one or two year reinsurance contract with the SPRV. In exchange for their investment, the capital market investors receive catastrophe bonds on which the ultimate return is based on the occurrence of a covered catastrophe event or the triggering of a catastrophe related index. These transactions typically do not involve significant independent equity, which is often held by a charitable foundation or similar entity that is otherwise independent of the transaction. Further, distribution of the SPRV assets to the bond investors at the expiration of the reinsurance contract (or following a payout after a covered event) requires prior approval by state insurance regulators.

Because the independent equity investment by the charitable entity is insufficient to allow the SPRV to finance its activities without relying on the financial support of the variable interest holders (Para 9. b.), the exposure draft would preclude consolidation of the SPRV on the basis of voting interests. The RAA agrees with this result.

Our reading of the exposure draft leads us to conclude that a reinsurance SPRV would be evaluated for consolidation based on variable interests. We generally agree with the requirement that the primary beneficiary that holds the majority of variable interests in the SPE should consolidate. Despite this, we question whether this result is logical for SPRV's. Since the typical structure of a catastrophe SPRV involves bond investors providing the largest investment in the entity, the draft would appear to require that the largest bond investor consolidate the SPRV. While this may be reflective of the fact that the ceding insurer's risk has been transferred to the bondholders, it does not seem logical that the largest bondholder should end up with the SPRV's bond obligations to the other bondholders on its balance sheet. The only other candidate for consolidating the SPRV is the ceding insurer. One might argue that because the ceding insurer stands to gain the most benefit if a triggering event occurs, that it should consolidate the SPRV. This however ignores the fact that the ceding insurer has paid a market premium to the SPRV to transfer its insurance risk to the bondholders and has no further obligation to the SPRV.

Because the occurrence of a triggering event in a typical catastrophe reinsurance transaction is expected to be rare, it is unclear whether the bondholders or ceding company would hold the greatest share of expected future losses. If no event occurs the cedant will lose 100% of the premium paid to the SPRV, whereas if a covered event occurs the bondholders could lose up to 100% of their principal. The evaluation of which party provides the largest portion of financial support considers only expected future losses and not potential benefits from the transaction. Perhaps the potential benefits should also be considered in the evaluation of variable interests for liability-based transactions through an SPE.

It is not clear whether the provisions in paragraphs 22 and 23 of the proposed interpretation were intended to govern the accounting for SPRV's. That is, neither the bondholders nor the ceding insurer would be considered to provide significant financial support through a variable interest with the conclusion that the SPRV has no primary beneficiary. It appears as though the typical SPRV would meet the qualifying criteria in paragraph 22 though the parties to the transaction (i.e., the bondholders and ceding insurer) would probably not meet at least two of the criteria in paragraph 23. In general, the regulatory requirement for prior approval of the distribution of trust assets would cause enterprises to fail the subparagraph 23 a. condition and the subparagraph 23 b. subordinated asset support condition would typically be inapplicable. However, the interpretation could be improved by clarifying how paragraphs 22 and 23 might be applied generally and specifically to an SPRV transaction.

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We believe the proposed interpretation is a good start to developing more specific guidance for consolidating SPE's. We encourage the FASB to more closely consider liability-based transactions such as reinsurance transactions through SPRV's as you finalize this guidance.

We appreciate the opportunity to provide comments on the FASB Proposed Interpretation and commend you for an excellent first draft. If you have questions or require further information, please contact me at sieverling@reinsurance.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Joe Sieverling", with a stylized flourish at the end.

Joseph B. Sieverling
Vice President and Director of Financial Services
Reinsurance Association of America