

Letter of Comment No: 10
File Reference: 1100-163
Date Received: 6/26/02

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June 26, 2002

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Gentlemen:

CIGNA Corporation is pleased to comment on the FASB Exposure Draft, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (SFAS 133) and associated draft DIG issues.

We commend the FASB for its efforts to synthesize and conform the guidance within SFAS 133 and the DIG issues. We believe that most of the proposed changes to existing guidance will improve accounting and reporting requirements for derivatives, and will help companies interpret and implement them. However, with respect to DIG Implementation Issue No. D2, *Applying Statement 133 to Beneficial Interests in Securitized Financial Assets* (Issue D2), we believe that the guidance - while theoretically consistent with the basic concepts of SFAS 133 - is not workable, and that the cost and difficulty of implementing it are not warranted. We think that existing guidance in EITF Issue No. 99-20 (EITF 99-20) is sufficient to ensure that losses on investments in beneficial interests in securitized financial assets are recognized on a timely basis, which makes the complexity of implementing Issue D2 hard to justify. We also believe that the accounting information that companies would generate to meet Issue D2's requirements would lack the necessary qualitative characteristics of relevance, reliability and comparability.

Buyers of beneficial interests in securitized financial assets (BIs) are not in a ready position to obtain the information needed to identify and value derivatives embedded in an underlying trust or other special purpose entity (SPE). Investors will have to rely on whatever information they can gather from reading prospectuses and making inquiries of issuers or administrators - including brokers, bankers, and investment bankers. Under current practices and requirements, a prospectus for an offering of a BI does not necessarily provide details

or analysis of derivatives or embedded derivatives within an SPE. Investors would need to perform time-consuming and subjective analysis to comply with Issue D2, including the following:

- Identify and evaluate features in relation to the characteristics of each of the various classes of beneficial interests to determine whether they are embedded derivatives. As is evident from the Issue D2 examples provided, the initial analysis is unusually complex from a technical accounting standpoint.
- In the case of embedded features deemed clearly and closely related to their host contracts, quantify their potential to double the BI's rate of return or threaten return of principal with respect to each class of security.
- For identified embedded derivatives, prepare cash flow projections and valuations - both initially and at each quarterly reporting date.
- Establish methodologies for allocating the cash flows and values of derivatives embedded in SPE holdings to the various classes of securities issued by the SPE. Methodologies for performing allocations of embedded derivatives to classes of securities are not addressed in the DIG Issue guidance.

The amount of time needed for a prospective investor to derive this information could easily exceed the available window of buying opportunity. Both initial and continuing valuation of identified embedded derivatives would be costly and impractical. Due to the subjectivity and complexity of the analysis and the varying degrees of accounting sophistication found between companies of different sizes and their independent accountants, various investors holding the same class of security of the same issuer would most likely generate diverse and inconsistent results. In addition to this lack of comparability, we believe that the embedded derivative information that would be reported under Issue D2 would lack reliability (or "representational faithfulness," as reliability is defined in FASB Statement of Financial Accounting Concepts No. 2).

In the case of freestanding derivatives, while their existence in an SPE may be more readily apparent than embedded derivatives at the time of initial investment, an actively managed SPE may enter into numerous derivatives after inception. Under current practice, the prospectus for an actively managed SPE might simply describe the possibility of investing in specified types of derivatives, with no requirement to detail actual derivative investments. Subsequent derivative activity could change the character of the investment without the investor's knowledge. This circumstance would make the ongoing Issue D2 requirements unworkable for investors. Investors are not in a position to do periodic identification and valuation of derivatives or embedded derivatives without heavy reliance on issuers or administrators of SPEs.

To achieve comparability among reporting entities and for Issue D2 to be operational, a requirement for quarterly SPE fair value reporting by *the*

issuer (or designated administrator) would have to become standard practice. Issuers would have to be charged with responsibility for:

- analyzing and identifying derivatives and embedded derivatives, both at inception and ongoing,
- projecting SPE cash flows and discounting them at an appropriate rate,
- determining and reporting fair values,
- allocating derivative fair values to the outstanding classes of securities in accordance with cash flow expectations and under the terms of the various instruments, and
- reporting the above in detail to each of the various BI holders, providing explanations and justification for underlying assumptions and judgments.

It is unlikely that most issuers are currently equipped to report this information in time for quarterly reporting deadlines. In fact, issuers of BIs today may not even be aware of the customer reporting requirements that could fall to them if Issue D2 is finalized. Nevertheless, centralized accounting and thorough analysis and reporting by the issuer would be a necessity to satisfy investors' needs and achieve comparability and reliability in reporting.

We question whether the benefit of the additional information to be reported under Issue D2 would warrant the significant incremental time and expense that would be required to produce it. We suggest that the FASB reconsider the benefit of this added burden, especially since EITF 99-20 already provides for current recognition in earnings of declines in fair value of BIs in SPE structures, including derivatives freestanding and embedded within them. In addition, under Statement of Financial Accounting Standards No. 115 (SFAS 115), increases in fair value are reported in other comprehensive income. The addition of the complex analytical work required by Issue D2 seems unwarranted when its primary accounting change from EITF 99-20 and SFAS 115 would be to accelerate realization in earnings of increases in the fair value of these embedded derivatives.

Considering the cost of implementing Issue D2 and the fact that EITF 99-20 already provides investors with the information necessary to determine investment losses on BIs, we question the relevance of Issue D2. As clearly explained in FASB Statement of Financial Accounting Concepts No. 2 (Statement 2):

To be relevant to investors, creditors, and others for investment, credit, and similar decisions, accounting information must be capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present and future events or to confirm or correct expectations.

We believe that the accounting information that would be produced by implementing Issue D2 would not satisfy this condition. We do not think

it would, as Statement 2 goes on to say, "make a difference to one who does not already have that information."

Because of the adequacy of EITF 99-20 and Issue D2's lack of (1) benefit in relation to cost, (2) comparability, (3) reliability, and (4) relevance, we suggest that the FASB revert to the provisions of DIG Implementation Issue No. D1 and remove beneficial interests in securitization transactions from the scope of SFAS 133. If the FASB does not support this as a final action, we suggest that the economic impact of Issue D2 be further investigated through a field study to determine how the proposed requirements of Issue D2 would affect the securitization market, from the perspectives of both issuers and investors.

As an insurance company, we offer the following observations:

- Many insurance companies routinely invest in asset-backed securities, which apportion cash flows from mortgages and other financial instruments. Although the related SPEs may not contain assets that are themselves derivatives or assets that contain embedded derivatives, under the Issue D2 examples the beneficial interests held may be deemed to have embedded derivatives. CIGNA holds nearly 1000 asset-backed securities that would require a full, time-consuming analysis to determine any embedded derivatives.
- The volume of potential investments subject to analysis, the complexity of the requirements and the unreliability of results could cause companies to fall back on the provision of SFAS 133, paragraph 16. That paragraph states that, if an entity cannot "reliably identify and measure" an embedded derivative, the entire security should be marked to market through earnings.
- This mark-to-market approach would be punitive to insurance companies that, in order to portray parallel results in the income statement of investments and investment contract or deposit liabilities, now classify most investment securities as held for sale under SFAS 115.
- Assuming the difficulties of implementing Issue D2 could be surmounted, we believe that the incremental effect of Issue D2 over EITF 99-20 and SFAS 115 - to reflect fair value "gains" from identified embedded derivatives in earnings - will mislead users of insurance company financial statements because liabilities are not similarly reported at fair value (they are carried at amortized cost).

Although Issue D2 was issued in draft form several months ago, it was not until the clarifying examples in Attachment 2 were posted to the FASB website on May 31 that its scope and application could be fully comprehended by most companies. This has not allowed sufficient time for companies to analyze fully the Issue's potential effects on its portfolios of asset-backed securities and other investments. If the FASB decides to go forward with the proposed requirements, we therefore recommend a one-year delay in their effective date to allow issuers and

investors the time needed to prepare to meet them. If a one-year delay is rejected, as a last resort we believe that the transition guidance should be changed, with prospective adoption for new BIs only and implementation for previously owned BIs effective in one year. This would permit investors time to analyze their existing portfolios of BIs and decide whether to implement the requirements or dispose of any investments for which the effort of implementation is unjustified.

If we can provide further information or clarification of our comments, please call me or Nancy Ruffino (860-226-4632).

Sincerely,

Jim Sears