

June 22, 2007



LETTER OF COMMENT NO. 83

Technical Director – File Reference No. 1530 – 100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

**Re: Proposed Statement of Financial Accounting Standards, Accounting for
Financial Guarantee Insurance Contracts, an Interpretation of FASB
Statement No. 60**

We appreciate the opportunity to comment on the Financial Accounting Standards Board's (FASB or the Board) Proposed Statement of Financial Accounting Standards, *Accounting for Financial Guarantee Insurance Contracts, an Interpretation of FASB Statement No. 60* (Proposed Statement or Exposure Draft). Ernst & Young commends the Board's efforts to address diversity in practice identified in the accounting for financial guarantee contracts issued by insurance enterprises.

While, we understand the Board's preference to limit the scope of the proposed Statement to financial guarantee contracts issued by insurance enterprises, conceptually, it would be preferable to have accounting guidance that addresses economically similar transactions. Guidance that addresses the accounting for similar transactions, such as mortgage guarantees, credit guarantees and credit default swaps would improve comparability between financial statements of insurance and non-insurance enterprises that offer similar forms of credit enhancement and would be more consistent with the Board's efforts to establish principles based standards. We believe fair value is the most appropriate measure of the obligation to perform under these types of transactions.

However, we respect the Board's preference that financial guarantee insurance contracts issued by insurance enterprises not be measured at fair value until a broader scope project is undertaken to review the accounting for all insurance contracts. To that end, the FASB should move forward with a joint FASB/IASB project to develop a comprehensive international accounting standard for all insurance contracts. In the interim, we support the issuance of a standard to provide guidance that will help to reduce the divergent practices that currently exist with respect to accounting for financial guarantee insurance contracts.

As our comments below and in the attached exhibit explain further, we disagree with certain key aspects of the proposed guidance. Specifically, we are concerned that the

“release-from-risk” concept underlying the proposed revenue recognition approach actually represents a departure from the short-duration model under FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises* (“Statement 60”), as it does not adequately reflect the amount of insurance protection that is being provided over the life of the contract. Furthermore, we do not believe the approach to estimating the claim liability (which we believe is actually more akin to a premium deficiency reserve calculation) is an appropriate interpretation of either the long duration or premium deficiency models in Statement 60 and, more importantly, does not adequately reflect the timing of incurred losses. We think that the proposed accounting model that results from this hybrid approach will add more complexity to the financial statements of financial guarantee insurers, as well as make it difficult for users to understand them. Accordingly, we do not support the issuance of a Standard based on the Exposure Draft without significant modifications.

If the Board decides not to recommend a fair value model, we believe the Board should reconsider the guidance in Statement 60 and issue a final standard that would require application of the short-duration accounting model as contemplated in that Statement for the recognition of premium revenue and claim liabilities. The short duration accounting model would provide a clearer depiction of the premiums and claims activity in the financial statements, more appropriately reflect the timing of incurred losses, and would meet the Board’s objective of reducing diversity in practice that exists with regard to the recognition and measurement of claim liabilities for financial guarantee contracts issued by insurance enterprises.

We would be pleased to discuss these issues in more detail at the Board or Staffs’ convenience.

Sincerely,

Ernst + Young LLP

Scope (Issues 1-3)

The Board concluded that the Proposed Statement would apply only to financial guarantee insurance (and reinsurance) contracts issued by insurance enterprises included within the scope of Statement 60. While we respect the Board's preference to narrow the scope of the Proposed Statement to focus on the application of Statement 60 to financial guarantee insurance contracts, we believe additional clarification is needed with regard to the following:

- The definition of a financial guarantee insurance contract, to help constituents understand how this Proposed Statement and FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("Statement 133"), as amended by FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, ("Statement 149") interact.
- Why other insurance contracts that are "similar" to financial guarantee insurance contracts, such as mortgage and credit guarantee insurance contracts, are not included within the scope of this Statement.
- Why enterprises that are not in the scope of this Statement may not apply or analogize to the guidance in this Statement to the extent they have provided guarantees with virtually identical characteristics to the financial guarantee insurance contracts written by insurance enterprises, particularly given the limited guidance provided in FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, regarding measurement of guarantees subsequent to initial recognition.

With regard to the definition of a financial guarantee contract, we believe more guidance is necessary because paragraph 10(d) of Statement 133 did not clearly contemplate the fact that the policyholder of a financial guarantee insurance contract might be the debtor/issuer of the insured financial obligation, and furthermore that the debtor/issuer might be a *trust*—two conditions that paragraph 3 of the Proposed Statement clearly contemplates. If the debtor/issuer is a trust, many constituents believe they must consider FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140* ("Statement 155"), in applying the guidance in paragraph 10(d).

We believe that constituents are uncertain as to exactly how the FASB intends preparers to apply paragraph 10(d) when the debtor/issuer is a trust. Specifically, paragraph 10(d) of Statement 133 states that financial guarantee contracts are exempt from Statement 133 only if:

- (1) They provide for payments to be made solely to reimburse the guaranteed party for failure of the debtor to satisfy its required payment obligations under

a nonderivative contract, either at pre-specified payment dates or accelerated payment dates as a result of the occurrence of an event of default (as defined in the financial obligation covered by the guarantee contract) or notice of acceleration being made to the debtor by the creditor.

- (2) Payment under the financial guarantee contract is made only if the debtor's obligation to make payments is as a result of conditions as described in (1) above is past due.
- (3) The guaranteed party is, as a precondition in the contract (or in the back-to-back arrangement, if applicable) for receiving payment of any claim under the guarantee, exposed to the risk of nonpayment both at inception of the financial guarantee contract and throughout its term either through direct legal ownership of the guaranteed obligation or through a back-to-back arrangement with another party that is required by the back-to-back arrangement to maintain direct ownership of the guaranteed obligation.

In contrast, paragraph 3 of the Proposed Statement states:

“The holder of the financial guarantee insurance contract (policyholder) will vary. In some cases, the policyholder will be the issuer (for example, a municipality, a corporation, or a *trust*) of the insured financial obligation because it is seeking to increase the marketability of the insured financial obligation while reducing future interest costs (by attaining a higher credit rating for the insured financial obligation through the financial guarantee insurance contract). In other cases, the policyholder will be the holder of the insured financial obligation because it has purchased a financial obligation in the secondary market and wants to protect itself from a financial loss in the event of a default.” (Emphasis added)

Paragraph 3 clarifies that the policyholder does not necessarily have to be the party at risk, or the ultimate beneficiary of the contract. Instead the policyholder might be the *issuer*. Furthermore, the policyholder/issuer might be a trust.

How does the FASB's evolving view of trusts, as gleaned from the Statement 140 amendment deliberations exploring the elimination of QSPEs, affect the application of the paragraph 10(d) exception when the policyholder of the financial guarantee is a trust? More specifically, “Who is the ‘debtor’?” There seem to be two broad possibilities:

- *View A*: The Trust is an entity with accounting significance and legal status, and therefore the “debtor” for purposes of considering the paragraph 10(d) exception.

Or

- *View B:* The Trust is nothing more than a pass-through entity, a transfer mechanism for non-recourse debt, so therefore the “debtor” is the “transferor” for purposes of considering the paragraph 10(d) exception.

Discussion of View A (The Trust is the “debtor”)

If the Trust is the “debtor” referred to in paragraph 10(d), many constituents believe they have to worry about Statement 155, because it seems to require a “looking into the Trust” to determine whether an interest in securitized financial assets is a freestanding derivative or contains embedded derivatives. Paragraph 14A of Statement 133 (as amended by Statement 155) states, in part, that the determination is based “on an analysis of the contractual terms of the interest in securitized financial assets, which requires an understanding of the nature and amount of assets, liabilities, and other financial instruments that compose the entire securitization transaction.”

The most extreme consequence of View A, where the Trust is the “debtor”, is that it could lead to the conclusion that the financial guarantees seeking the paragraph 10(d) exception must be narrowly written to orient only to the default of the Trust’s assets. Our understanding is that virtually no financial guarantees on obligations of Trusts are written this way and, under this view, all such financial guarantees would be derivatives and outside the scope of this Proposed Statement.

We do not believe the Board intended this result, so we believe that if the Board views the Trust as the debtor, the Board must envision the paragraph 10(d) analysis to focus not on the Trust’s assets but on the issued obligation itself (the beneficial interest in securitized financial assets). However, we are still unsure how the criteria of paragraph 10(d) should be considered for a beneficial interest, which arguably, cannot “default” since the debt is effectively non recourse. For example, a senior beneficial interest holder is only promised senior rights to whatever cash flows actually occur from the underlying assets (e.g., mortgages). What precisely does the FASB intend “default” to mean in this context?

Even if the focus is allowed to be on the issued obligation of the Trust, how does the presence of interest rate derivatives inside the Trust affect or not affect the consideration of paragraph 10(d) of Statement 133? The issued obligation is a non-derivative contract, but it might have interest rate derivatives embedded in it based on a Statement 155 analysis. This might occur for example if a Trust is structured with fixed-rate assets and floating-rate beneficial interests, and an interest rate derivative inside the Trust is either not present, or if present, does not completely eliminate interest rate mismatch risk. How is the accounting for the financial guarantee influenced or not influenced by the accounting that the investor in the beneficial interest must follow under Statement 155? If the financial guarantee indirectly provides some sort of “safety net” protection for interest rate mismatch risk that the interest rate swap itself is not completely covered by,

is the financial guarantee exception of paragraph 10(d) entirely unavailable, partially unavailable, or unaffected by this analysis?

If the Board does not intend a Statement 155 analysis to be required to accompany the paragraph 10(d) of Statement 133 financial guarantee exception analysis, this Proposed Statement should so clarify. If the Board does intend Statement 155 to be considered, the Board needs to provide explanatory guidance.

Discussion of View B (The Trust is a pass-through; the Transferor is "the Debtor")

If the "debtor" for purposes of the paragraph 10(d) analysis is effectively the transferor, on the theory that the Trust is merely a pass-through conduit or transfer mechanism, then the accounting complexity of applying the paragraph 10(d) analysis appears to be greatly reduced. If the presence of the Trust can be ignored, then seemingly, so can the questions about whether to apply, or how to apply, Statement 155's "look inside the Trust" framework.

The consequence of ignoring the Trust and focusing directly on the obligation is that economically the financial guarantor could be effectively "wrapping" interest rate protection if the reason the debtor is not satisfying its "required" payment obligation is, for example, a notional mismatch on the interest rate swap that is attempting to address fixed-rate mortgages supporting variable-rate obligations. Under this view, the reasons for the "default" do not need to be investigated for purposes of evaluating paragraph 10(d) even if the wrapped assets are all derivatives.

We believe View B is attractive for both its ease of application of paragraph 10(d) of Statement 133 and because it appears to conform with the direction the Board is heading to reduce complexity in Statement 140 by removing the qualifying SPE concept and to record transfers of financial assets in accordance with the economics of the transaction.

However, we need directional guidance from the FASB as to its intent.

In that regard, we believe that through the issuance of this Proposed Statement, a conforming change should be made to paragraph 10(d) of Statement 133 that would clarify how it should be applied to financial guarantees where the policyholder is the issuer of the insured financial obligation, and how (or if) Statement 155 must be considered if that issuer is a trust and the insured financial obligation is a beneficial interest in securitized financial assets.

Revenue Recognition (Issues 8-11)

In developing the Proposed Statement, the Board opted against a fair value model in favor of what it considers an interpretation of Statement 60. Under the proposed revenue recognition approach (which the Exposure Draft indicates is based on the Statement 60 short-duration model), premium revenue is determined each reporting period based on the ratio of insured contractual payments made during the reporting period to total insured contractual payments to be made over the period of the contract. While the proposed approach appears to provide a mechanism of recognizing revenue over a contract's life that is consistent for all financial guarantee insurance contracts, we are concerned that it actually represents a departure from the short-duration model under Statement 60, which requires premiums to be recognized as revenue over the period of the contract (or period of risk, if different) in proportion to the amount of insurance protection provided. Specifically, we believe the proposed guidance, which results in no revenue being recognized until the insurer's exposure is reduced via principal and/or interest payments on the insured financial obligation:

- 1) Does not adequately reflect the "amount of insurance protection that is being provided over the life of the contract" (in particular, for zero coupon bonds or bonds with a bullet principal payment); and
- 2) Fails to recognize that the "period of risk" may differ from the contractual term of the insured financial obligation, (as may be the case for financial guarantees of insured financial obligations subject to prepayment risk, such as mortgage-backed or other asset-backed obligations).

As noted in the foregoing paragraph, the proposed revenue recognition approach is based on a "release-from-risk" concept, which results in no revenue being recognized until the insurer's exposure is reduced via principal and/or interest payments on the insured financial obligation. For example, for a guarantee of a zero coupon bond, revenue is not recognized until the last day of the contract. This approach fails to recognize the fact that economically the insurer is protecting the policyholder (or investor/beneficiary) against the risk of default by the debtor/issuer over the entire term of the insured financial obligation. The guarantee serves to eliminate the default risk (which otherwise would have been represented by the increased interest required over a similar risk-free financial instrument) to the investor, while at the same time generally reducing the overall cost of borrowing funds for the debtor/issuer. Absent the guarantee, the debtor would have had to recognize additional interest expense over the life of the borrowing (conversely, the investor would have recognized additional interest income as compensation for the default risk assumed over the life of the security). Therefore, it seems logical that the guarantor should recognize this risk premium over the life of the insured financial obligation as it is assuming the default risk.

Another concern regarding the proposed revenue recognition approach is that it fails to recognize that the "*period of risk*" may differ from the contractual term of the insured

financial obligation. For financial guarantees of insured financial obligations subject to prepayment risk (such as mortgage-backed or other asset-backed obligations), revenues may not be appropriately recognized over the period of risk as, historically, it has been observed that the average lives of mortgage-backed and other asset-backed obligations is significantly shorter than their contractual lives. The requirement to recognize revenues based on the ratio of insured contractual payments made during the reporting period to total insured contractual payments made over the period of the contract does not accurately depict the pricing or economics of the guarantee and underlying insured financial obligation and, as a result, will require ongoing accounting adjustments to true-up premiums earned and the related unearned premium reserve.

Finally, if the Board's view is that the principle underlying the Statement 60 revenue recognition model for short-duration insurance contracts is a "release-from-risk" concept, we are concerned that the proposed revenue recognition model could be viewed as amending existing literature relating to an insurer's premium recognition for many other short-duration coverages (e.g., excess of loss contracts, including property coverage for wind/storm damage, directors and officers insurance, etc.) where premium revenue is generally recognized evenly over the contract period. For example, if the "release from risk" concept were applied to an excess of loss contract with an aggregate limit, revenue would not be recognized until a loss occurs and coverage has been utilized. If no loss occurs, no revenue would be recognized until the policy expires, even though the insurer is providing coverage each and every day over the term of the contract.

If the Board intends to apply the Statement 60 short-duration model to financial guarantee insurance contracts, we believe revenue should be earned over the life of the contract in proportion to the amount of insurance coverage provided. A straight-forward approach that is based on the ratio of insured principal or par value outstanding during the reporting period to total par value outstanding over the expected life of the contract (e.g., with total par value determined based on a sum of the year digits method) may provide a simple, yet more appropriate depiction of the "insurance protection" or "coverage" provided by the insurer over the term of the insured financial obligation.

This approach is consistent with how many guarantors currently recognize revenue for insured financial obligations with sinking funds and those subject to prepayment risk, and, effectively results in a decrease in revenues over the life of the contract, consistent with the decrease in insured principal outstanding (i.e., as the amount of insurance protection declines). This approach also could be applied to a zero coupon bond (based on a reverse sum of the years digits method), and would result in greater revenue being recognized as the outstanding principal balance accretes up to par (i.e., as more insurance protection is being provided).

Our above proposals are based on our belief that par value outstanding is the most appropriate measure of an insurer's exposure because, once the issuer of the insured

financial obligation has defaulted, the insurer generally has the ability to fully settle the claim by immediately paying off the outstanding principal (and any outstanding interest up to that date). Thus, the insurer's exposure is limited to insured principal and accrued interest. We also believe using an approach that results in the recognition of revenue over the expected life as opposed to contractual life of the insured financial obligation, represents a more appropriate interpretation of the guidance in Statement 60, and will result in a revenue stream that is more reflective of the underlying economics of such transactions.

Unearned Premium Revenue and Related Premium Receivable (Issues 4-7)

This proposed Statement would require that an insurer recognize a liability for unearned premium revenue in its entirety at the inception of a financial guarantee insurance contract. A corresponding premium receivable would be recognized at inception of the contract for future premium installments to which the insurer, by contract, is entitled. Initial measurement of the premium receivable and liability for unearned premium would be based on the present value of the premium due over the contractual term of the contract discounted using a rate reflecting the policyholder's credit standing at inception of the contract. The discounted amount on the premium receivable would be accreted through investment income over the period of the contract in accordance with Accounting Principles Board Opinion No. 21, *Interest on Receivables and Payables*.

While we acknowledge the need to establish an unearned premium reserve for contracts when the premium is collected up front (e.g., for guarantees of bonds issued in the public finance or municipal sectors), we question the need to establish a receivable and corresponding unearned premium reserve for all future premium installments when those installments are determined based on the amount of insurance protection provided during the installment period (e.g., for guarantees of financial obligations subject to prepayment risk, where premium installments are generally based on insured principal outstanding during the period). The view taken by the Board is that installment premiums are a form of financing as the overall relationship between the parties to the debt offering establishes a contractual commitment to pay premium as long as the insured financial obligation is outstanding. While we acknowledge the theoretical argument behind this viewpoint, we believe recording a receivable and corresponding unearned premium reserve based on insured contractual payments will:

- 1) Result in an overstatement of the balances at inception of the contract; and
- 2) Add an unnecessary level of complexity for users and preparers of the financial statements due to the ongoing adjustments that will be required to unwind the discount on the portion of the premium receivable that is never paid and to true up the amortization of the unearned premium reserve.

Using the contractual life to determine the present value of future premiums associated with a guarantee of a mortgage-backed or other asset-backed obligation will result in an over-statement of the premium receivable and unearned premium liability at inception of the contract because, as noted in the foregoing section on revenue recognition, the average lives of mortgage-backed and asset-backed obligations are significantly shorter than their contractual lives. When the actual life is shorter than the contractual life, it will require a portion of the initial premium plus any related accrued interest to be reversed (i.e., companies will recognize revenue and accrete interest income only to reverse it at a later date). Furthermore, because companies do not expect to collect all the installment premiums, they may have to record an allowance at inception of the contract to comply with paragraph 11 of the Exposure Draft. This adds an unnecessary level of complexity to the financial statements and would appear to be an unintended consequence of the proposed model.

If, however, the Board maintains its position that installment premiums are a form of financing and, issues a final Statement that requires the insurer to recognize a receivable and corresponding unearned premium reserve for premium to which it is contractually entitled, we believe the following principle should be applied to determine premium receivable and unearned premium reserve at inception of the contract: a) if payments made on the underlying insured financial obligation are fixed and determinable, the premium receivable and corresponding unearned premium reserve should be determined based on the present value of premium due over the contractual term of the financial guarantee insurance contract; b) if payments made on the underlying insured financial obligation are not fixed, but the amount and timing of such payments can be reasonably estimated, the premium receivable and corresponding unearned premium reserve should be determined based on the present value of premiums due over the expected term of the financial guarantee insurance contract.

In light of the issues identified in the foregoing paragraphs, we believe, for insured financial obligations in which the amount and timing of insured contract payments are not fixed (e.g., for mortgage-backed and other asset-backed obligations), that expected life is a more appropriate basis for the initial measurement of the liability for unearned premium and related installment premium receivable. A number of different prepayment models currently exist and are regularly used in the marketplace to price mortgage-backed and other asset-backed securities (including securities backed by home equity loans, auto loans and leases, student loans and credit card debt). Accordingly, we believe guarantors will be able to reliably estimate future premium installments.

Regardless of the period used (i.e., contractual life or expected life), we believe additional guidance should be provided on how to “unwind” the discount on the premium receivable and adjust the unearned premium reserve to account for differences between actual and expected cashflows over the term of the insured financial obligation. The Board may wish to consider the guidance in paragraph 24 of FASB Statement No. 113,

Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts, EITF No. 93-6, *Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises*, and paragraph 25 of FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, to recommend an approach to account for differences between actual and expected cashflows that would be consistent with current insurance accounting guidance.

Refundings (Issue 12)

We agree with the proposed accounting for refundings.

Claim Liability (Issues 13-15)

The Proposed Statement purports that the claim liability recognition and measurement approach was developed in the context of the long duration insurance accounting model in Statement 60, and requires that an insurer recognize a claim liability on a financial guarantee insurance contract when the insurer expects, based on the present value of expected cash flows, that a claim loss will exceed the unearned premium revenue liability on that contract. We do not believe that using this approach as the basis for estimating the claim liability (which we believe is actually more akin to a premium deficiency reserve calculation) is appropriate for financial guarantee insurance contracts. Specifically, the proposed approach to determining the claim liability is not an appropriate interpretation of either the long duration or premium deficiency models in Statement 60 will add more complexity to guarantor's financial statements and, more importantly, does not adequately reflect the timing of incurred losses.

We believe the proposed methodology for recognizing a claim liability is more akin to a premium deficiency reserve calculation than the long-duration claim recognition model under Statement 60. However, we believe the proposed approach is not in accordance with Statement 60 as it requires the equivalent of a premium deficiency reserve to be calculated on an individual policy basis. Both the premium deficiency and long-duration models in Statement 60 permit the grouping of insurance contracts to determine whether reserves for a group of contracts are sufficient to cover expected losses on that group of contracts. This is due to the fact that insurers price such contracts assuming they can spread the total costs of similar risks among large groups of policyholders (i.e., based on the "law of large numbers").

Even if a long-duration model were used, we do not believe it would be appropriate for financial guarantee contracts as it would not appropriately reflect actual losses in the portfolio. The long duration model, which was developed to address the accounting for contracts that have level premiums but the exposure to loss increases over time (e.g., the likelihood of paying a death benefit on a life insurance contract increases over time)

would not be appropriate for financial guarantee insurance contracts as exposure to loss on an insured financial obligation may vary and actually decrease over time (as noted in the foregoing section on revenue recognition).

We also believe that the proposed approach to recognizing claim liabilities is inappropriate considering the Board decided to use the short-duration insurance accounting model as the basis for determining premium revenue and amortization of the unearned premium liability. We think that the proposed accounting model that results from this hybrid approach will add more complexity to the financial statements of financial guarantee insurers, as well as make it difficult for users to understand them. Specifically, it is not clear how adjustments to the unearned premium reserve, premium receivable, and deferred acquisition costs should be reflected in the financial statements as a result of the establishment of a claim liability.

For example, assume that there is an unearned premium reserve of \$100 with a corresponding premium receivable of \$100 and deferred acquisition costs of \$10. The financial guarantee insurer expects negative cash flows of \$1,000, which represents the present value of the total principal and interest outstanding at that point in time. The guidance suggests that a claim liability of \$900 would be recorded such that the unearned premium reserve of \$100 plus the claim liability of \$900 will equal \$1,000. However, what adjustments to the unearned premium reserve, premium receivable, and deferred acquisition costs should be made as a result of the establishment of a claim liability, if the insurer no longer expects to collect the entire premium receivable amount due to the expected default? Furthermore, how would such adjustments be reflected in the financial statements?

We believe the short duration accounting model for determining claim liabilities in Statement 60 is more appropriate considering the approach to premium revenue recognition in the Proposed Statement. It would provide a clearer depiction of the premiums and claims activity in the financial statements, more appropriately reflect the timing of incurred losses, and would meet the Board's objective of reducing diversity in practice that exists with regard to the recognition and measurement of claim liabilities for financial guarantee contracts issued by insurance enterprises.

We do not object to the proposed approach of estimating a claim liability based on expected cash flows using assumptions consistent with those documented in the insurance enterprise's surveillance list about the credit deterioration of an insured financial obligation, as long as the estimate is in accordance with FASB Statement No. 5, *Accounting for Contingencies*, which serves as the basis for claim liability recognition for short-duration contracts in Statement 60. Nor do we object to discounting expected cash flows based on the risk free rate adjusted for the credit standing of the insurance enterprise. However, we believe the final model should lock in the interest rate upon establishment of the claim liability (i.e., if using the short-duration model to establish

claim liabilities, losses would only be recognized when incurred; thus there would be no distinction between a pre-claim liability and a claim liability and, as a result, no need to adjust the discount rate upon default).

Finally, we would like to point out that the Proposed Statement has conflicting guidance on the reporting of interest related items. Specifically, the Proposed Statement would require accretion of the discount on claim liabilities to be reported as a change in incurred losses while the discount on the premium receivable would be required to be reported as interest income (as opposed to premiums earned). The Board should consider whether such items should be given consistent treatment.

Disclosures (Issue 16)

We agree that the proposed disclosures will assist financial statement users in understanding the financial information for insurance enterprises that issue financial guarantee insurance contracts and believe such disclosures are consistent with information that is already being disclosed by financial guarantee insurers in other forums. However, if the Board determines it is not necessary for companies to record a premium receivable and corresponding unearned premium reserve for future installment premiums, the disclosures in items b. and c. of paragraph 26 would not be needed. Additionally, because the insurer generally has the ability to fully settle the claim by immediately paying off the outstanding principal, we believe the disclosure in item d. (4) of paragraph 26 should be limited to insured principal outstanding.

Effective Date and Transition (Issues 17-18)

The Proposed Statement, as currently drafted, will result in a significant change in insurers' accounting for financial guarantee insurance contracts, particularly as it relates to premium revenue recognition. Therefore, we do not believe it is practicable to require retrospective application, and agree with the proposed transition provision to recognize the cumulative effect of initially applying the Statement as an adjustment to the opening balance of retained earnings as of the beginning of the year in which this Statement becomes effective.

However, given the concerns expressed herein regarding the application of the proposed Statement, we question whether a final Statement can be issued by the third quarter of 2007. Even if a final Statement were issued by then, we do not believe that it would provide insurers with sufficient time to implement the Statement by the first quarter of 2008.

Once the Statement is final, sufficient time will be needed to allow companies to develop, adapt, and test systems and processes to ensure compliance. While we do not believe a full year is necessary to implement such changes, we understand that users of the

June 22, 2007
Page 14

financial statements prefer new guidance to be implemented at the beginning of a fiscal year. Therefore, we recommend that the effective date of the Statement be extended to fiscal years beginning after December 15, 2008 to allow companies and their independent auditors sufficient time to address the substantive and procedural changes required by the Statement.