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LETTER OF COMMENT NO. 10

December 12, 2008

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

**Re: Global Economic Crisis Roundtable Follow Up**

Dear Chairman Herz:

The American Council of Life Insurers ("ACLI")<sup>1</sup> is very concerned about the apparent direction of the FASB in addressing the near term need for accounting change in response to the current economic crisis. The FASB has expressed through speeches as well as commentary in the recent roundtables on the global financial crisis hosted jointly by the FASB and IASB its concern about implementing changes to the accounting standards for fair value and other than temporary impairment. The FASB has indicated its intention to address the concern expressed by industry via financial statement disclosure rather than implementing changes to current guidance. While certainly disclosure is a useful tool that can provide much needed explanation and data to financial statement users, it should not be used as a replacement for adequately addressing the accounting changes required to address the current crisis.

The current economic crisis has highlighted the flaws of the other than temporary impairment model for available for sale (AFS) securities in FASB Statement No. 115 ("FAS 115") and the need to provide better information to financial statement users regarding liquidity issues and the impact of credit versus market losses on securities. We believe that changes to existing accounting guidance can be quickly implemented; provide for convergence with IAS 39; and address many concerns of industry while providing meaningful information to analysts and other financial statement users. We believe that the Board should focus primarily on two items to address our current fair value accounting concerns: **1) Improve the trigger for other than temporary impairment on securities by eliminating the intent and ability to hold requirement of FAS 115 and replace it with objective evidence of a credit event; 2) Improve provisions of FAS 115 to provide for further use of the held to maturity (HTM) category for cash flow investors.**

These changes focus on FAS 115. While we continue to believe that FAS 157 also lacks adequate guidance to account for securities trading in dislocated markets, we have not included recommendations to address FAS 157 in the near term. It is clear to us that the analyst community is committed to the exit value model provided by FAS 157 and while we believe it shows values that are inconsistent with true economic values, we will forego this argument in recognition of the preference of the Board and the

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<sup>1</sup> The ACLI represents three hundred fifty-three (353) member companies operating in the United States, of which three hundred forty-five (345) are legal reserve life insurance companies, and eight (8) are fraternal benefit societies. These 353 member companies account for 93 percent of total assets, 93 percent of the life insurance premiums, and 94 percent of annuity considerations in the United States.

analysts. Instead, we intend to focus on the changes that can be and should be made to FAS 115 that we believe will improve financial reporting and convergence with IFRS.

It has been mentioned in the public roundtables that FAS 115 has been around for quite some time and is tried and true. We are not in agreement with this belief. We are experiencing an economic crisis of a magnitude not seen since FAS 115 was implemented in 1994. Moreover, many of the provisions of FAS 115 that we have concern with have not been in effect during the entire life of the statement. The rigid view of positive intent and ability to hold to recovery for otherwise temporarily impaired AFS securities has only been in effect for the past five years or so. As this view was emerging, industry was very outspoken about the risk of that model in an environment similar to the one we are in today, and now we are headed away from a fair value model for AFS securities to a lower of cost or market model. The implementation of FAS 157 this year has further exaggerated the impact of these artificial triggers in financial reporting.

The following is a summary of our recommendation:

#### **Other Than Temporary Impairment**

Fair values of all securities included in the AFS category under FAS 115 are recorded in the balance sheet with the changes in fair value reported through other comprehensive income. The issue the industry believes needs to be addressed is the trigger that requires those fair value changes to be recorded into the income statement. In our discussion, we are mostly concerned with the treatment of fixed income securities.

We ask that the FASB modify FAS 115 and associated FSPs to remove "intent to hold" criteria for recording other than temporary impairments, and replace with objective evidence of a credit event, such as either a default or a debt restructuring, as impairment triggers. This would align with the impairment model for other assets that are not securities, such as loans and receivables, and with IFRS. It would also provide a more meaningful distinction of fair value changes recorded through OCI, versus those recorded through income, than that provided by the current model. It would also remove the distorting effect on an insurer's operating income of taking impairment losses for securities that are "money good", then amortizing an exaggerated discount into earnings over remaining maturity. Fair value changes recorded into the income statement using the current model are very often determined based on arbitrary bright lines and company-specific intent and ability to hold a security to recovery. If intent and ability cannot be asserted on a security or a portfolio of securities, the resulting lower of cost or market accounting is not a preferred accounting model. It also results in materially different treatment of like assets depending on whether they are securities or not.

We are not convinced that a change to this requirement is inconsistent with the Conceptual Framework. Nor do we believe that it is inconsistent with the general direction of new accounting guidance provided by the FASB or the efforts around convergence. The change can be made and implemented quickly and we ask for consideration by the Board of such action.

#### **Held to Maturity category**

The HTM category under FAS 115 has long been a problem for the insurance industry. While there are three categories provided by FAS 115, there is only one that is used by the industry in a significant way – the AFS category. In fact, the AFS category is broadly used and applied to assets of companies that manage on a total return basis that are actively traded and those of companies that are cash flow matched with liabilities providing for minimal trading. We believe that the intent of the HTM category is to accommodate investors that use securities for cash flow matching and recognize that the fair value of such instruments should be disclosed but not reported in the balance sheet unless other than temporarily impaired. Unfortunately, cash flow models change and companies need the flexibility to

trade securities from time-to-time to accommodate an active asset-liability matched (“ALM”) management style as well as to respond to unforeseen liquidity needs. A cash flow matched investor may turn over 10% of its portfolio versus a total return manager that could turn over greater than 100% of its portfolio. However both would fail the tainting provisions of HTM in FAS 115 as it is written today. We believe that the accounting should provide for a distinction between these two investors. Today, the restrictions of the HTM category and the volatility created by the use of the trading category result in both investors using the AFS category.

The current lack of liquidity in the market place has made the use of the HTM model more attractive for many insurers:

- Given that GAAP does not permit a loans and receivables category similar to IFRS, we believe that FASB should consider revisiting the intent to hold provisions of the HTM category to make it more widely available, and
- The guidance should allow companies to transfer securities into this category. This will provide for greater consistency and comparison for US GAAP filers with that of IFRS filers and provide for better insight into the use of different assets by different companies. We believe that understanding if a company is cash flow matched and investing with a HTM model versus a company that is not cash flow matched and investing for total return is an important distinction that investors today cannot ascertain from the financial statements.

In summary, these uncertain and difficult periods challenge the accounting model and due process for setting standards. While our industry has previously expressed many of the concerns that we articulate in this letter about FAS 115, the magnitude and breadth of the global economic crisis has shown very acutely the flaws of the other than temporary impairment model in U.S. GAAP. The need to address this is critical and it is urgent. As much as we support and appreciate the due process that the FASB provides in its standards setting, we believe that this need to respond to the flaws within FAS 115 trumps that need. We believe that the Board should act promptly to issue guidance that provides for a meaningful change to address accounting for fixed income securities as described in our recommendations by the end of the year. Disclosure alone will not address the issue of a flawed accounting model. We welcome any additional questions or concerns you wish to discuss.

Sincerely,



Michael M. Monahan  
Director, Accounting Policy

cc: Chairman Christopher Cox, U.S. Securities and Exchange Commission