



April 2, 2009

LETTER OF COMMENT NO. 32

Harvey J. Goldschmid
Hans Hoogervorst
Chairmen
IASB/FASB Joint Financial Crisis Advisory Group
c/o Financial Accounting Services Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: FCAG Written Submissions from Constituents

Gentlemen:

The Group of North American Insurance Enterprises (GNAIE) consists of leading insurance companies including life insurers, non-life insurers, and reinsurers. GNAIE members include companies who are among the largest global providers of insurance and substantial multi-national corporations. We are writing today to provide input to the IASB/FASB Financial Crisis Advisory Group (FCAG) as it continues its discussions concerning the recent events in world financial markets. Please find below our responses to the questions in the invitation to comment.

1. From your perspective, where has general purpose financial reporting helped identify issues of concern during the financial crisis? Where has it not helped, or even possibly created unnecessary concerns? Please be as specific as possible in your answers.

In this crisis the requirement to apply "fair value" measurements and fair value based impairments to debt instruments in circumstances where the markets for those instruments became inactive, illiquid and disorderly has distorted the balance sheet results of entities who otherwise are receiving the promised cash-flow and have no intent or compulsion to sell. The resulting degradation of the balance sheets of financial services companies has generated pro-cyclical effects that have depressed asset prices not only for instruments affected by the subprime mortgage and housing crisis, but also many, many related securities that otherwise would have retained their value. The requirement of financial institutions to maintain capital levels and in some cases post new collateral has dried up credit liquidity in general.

The argument has been made that FAS 157 does not require the use of market value from "distressed sales" as inputs to level 3 valuations. The guidance up to now, however, was either unclear as to the means of determining if a given transaction was a distressed sale or unrealistic as to the information a holder would have as to the circumstances of a transaction between two unrelated parties. The recently released FSP 157-e has the potential for alleviating these difficulties, if the wording is amended so that it operates in the manner that has been described.

Jerry M. de St. Paer
Executive Chair

Douglas Wm. Barnert
Executive Director

Group of North American Insurance Enterprises
40 Exchange Place, Suite 1707
New York, NY 10005
UNITED STATES

++1-212-480-0808
info@gnaie.net
www.gnaie.net

The relevance of a price from a transaction between third parties to the holding value of an asset on the books of the reporting entity is dependant on the assumption that the price is derived from both the buyer and the seller acting on all reasonably available information and in their best, highest interest. You cannot make that assumption in the case of an illiquid, inactive, disorderly market due to the potential for economic disconnects between the holder and the prospective buyer and uncertainty regarding economic motivations that are unrelated to the value of the instrument.

Asset valuations must be consistent with management's intent, otherwise the financial statements are unlikely to be consistent with expectations of future cash flows, and may reflect the liquidation value of the entity as opposed to the going concern value. A price derived from an active, orderly, liquid market should be broadly consistent with management intent, because it reflects both the buyer and the seller's objective view of the utility and risk of the balance sheet item. Prices from inactive, illiquid, or disorderly markets fail that assumption for securities that management will hold, because the price in a disorderly market will likely be a function of intents and circumstances unrelated to the present value of the probable future cash flow. It is either impossible or unreliable to attempt to separate those extraneous price drivers from a distressed price to derive a hypothetical exit price.

By the same token an impairment model that requires distressed securities to be written down to a value derived from an inactive, illiquid, disorderly market makes little sense. Sharp drops in market value are frequently the result of some degradation in credit worthiness that would rationally trigger an impairment in book value. However, the extraneous price drivers of concurrent transactions may force the price much lower than a rational estimate of the decline in the probability of payment. The severity and duration of the current market disruptions related to declines in credit liquidity and pro-cyclical pressures render interpretations of "other than temporary" difficult at best. This problem is compounded by the fact that the write-downs are unrecoverable.

Again, the recently released FAS 115-a/FAS 124-a/EITF 99-20-b potentially alleviates many of these difficulties. The separation of the write-down, into credit impairment through profit and loss and residual through OCI, properly acknowledges the uncertainty of whether the entire fair value based impairment is relevant to the value of the holder. We remain somewhat concerned with the ability of entities to determine the credit loss to the satisfaction of auditors, but believe this proposal is going in the right direction. We would also like to encourage consideration of proposals to allow reversal of permanent write-downs

3. Some FCAG members have indicated that they believe issues surrounding accounting for off-balance items such as securitizations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair value (including mark-to-market) accounting. Do you agree, and how can we best improve IFRS and US GAAP in that area?

No, we do not agree. While market pressures may have revealed weaknesses in the guidance for consolidation and derecognition, there is no basis to conclude that repairing those weaknesses would have magically fixed the issues surrounding fair value. In addition, the issues surrounding off-balance sheet items can be understood as problems with the valuation of risk.

What is important to users is a fair picture of the obligations of the company. The problem is not whether a particular asset or liability appears on the balance sheet, but whether the risk is captured. Determining the materiality or value of risk in complex securitizations or other structures requires

methods beyond simple theories of the market's ability to monetize the risk of liabilities. Some risks (like reputation risk) may be beyond difficult.

4. Most constituents agree that the current mixed attributes model for accounting and reporting of financial instruments under IFRS and US GAAP is overly complex and otherwise suboptimal. Some constituents (mainly investors) support reporting all financial instruments at fair value. Others support a refined mixed attributes model. Which approach do you support and why? If you support a refined mixed attributes model, what should that look like, and why, and do you view that as an interim step toward full fair value or as an end goal? Whichever approach you support, what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?

Investors want not only an objective value, but also one that is consistent with use of the assets and liabilities being analyzed.

We support a valuation system that has the flexibility to reflect how the balance sheet item is being used. We support the three categories present today in US GAAP, but we also encourage the discussion occurring as part of the Financial Instruments: Improvements to Recognition and Measurement Project. The three attributes discussed as candidates at the March 24 Joint Meeting are an appropriate starting point.

HTM is a critical category and is in need of a serious overhaul. The requirement that a *security* be permanently designated as HTM does not reflect the ability or need of management to manage a *portfolio* of securities held for their ultimate cash-flow. Management should be permitted to move or sell HTM securities in reaction to changes in conditions, as long as it is clear that the basic dynamic between the HTM portfolio and its intended use are maintained.

We support simplification and convergence of the impairment rules, but we do not support the use of an impairment test that requires write-down all the way to fair-value when the market for the instrument is illiquid, inactive and disorderly. The separation proposal in FAS 115-a/FAS 124-a/EITF 99-20-b is potentially a solution.

5. What criteria should accounting standard-setters consider in balancing the need for resolving an 'emergency issue' on a timely basis and the need for active engagement from constituents through due process to help ensure high quality standards that are broadly accepted?

We believe the Boards should establish and maintain minimum due process procedures to allow for full review of the standards. While we acknowledge the requirements of Section 19 (b) of the Securities Act of 1933, the boards should consciously take steps to address emerging crises, seek and fully consider feedback from affected interested parties, and focus on impact assessments and field testing to ensure that issued and proposed standards don't have unanticipated negative consequences.

It became clear that there was a global financial crisis in late 2007. Had there been substantive consideration of the appropriateness of fair value accounting in the presence of illiquid, inactive, disorderly markets and satisfactory action by the FASB or IASB in the 12 months that preceded the EU demands, it is unlikely there would have been an "emergency issue".

That said, we agree with the FCAG panelist who said that an emergency is the time to open the doors as wide as they go, rather than slam them shut. Outreach and engagement in situations with limited time for comments should be greater, not less. These situations, when they arise, are times when the boards



must also engage in thorough and far-reaching follow-up to ensure that “emergency” changes are having their intended effect.

6. Are there financial crisis-related issues that the IASB or the FASB have indicated they will be addressing that you believe are better addressed in combination with, or alternatively by, other organizations? If so, which issues and why, and which organizations?

No.

7. Is there any other input that you'd like to convey to the FCAG?

Please refer to our responses to the questions in the Agenda Paper for the second meeting, which we sent to FCAG staff prior to that meeting (attached).

The discussions and debate of the Group have illuminated the difficulties in achieving a single, clear, theoretical solution. Although perhaps unsatisfactory, we feel it is important that the conclusions reached reflect the disagreements. We thank the FCAG for the opportunity to comment and look forward to the results of the Group's work.

Sincerely,

A handwritten signature in black ink, appearing to read "Jerry de St. Paer". The signature is written in a cursive, flowing style with some capitalization.

Jerry de St. Paer
Executive Chairman
Group of North American Insurance Enterprises



FCAG Written Submissions Attachment

February 12, 2009

To the Co-Chairs of the Financial Crisis Advisory Group

Mr. Harvey Goldschmid

Mr. Hans Hoogervorst, Chairman

Netherlands Authority for the Financial Markets (AFM)

copies to: Mr. Robert H. Herz, Chair, Financial Accounting Standards Board (FASB)
Sir David Tweedie, Chair, International Accounting Standards Board (IASB)
Mr. Jeffrey D. Mechanick, Project Manager, (FASB)

Gentlemen:

The Group of North American Insurance Enterprises (GNAIE) consists of leading insurance companies including life insurers, property and casualty (“non-life”) insurers, and reinsurers. GNAIE members include companies who are among the largest global providers of insurance and substantial multi-national corporations. We are writing today to provide input to the IASB/FASB Financial Crisis Advisory Group (FCAG) as it continues its discussions concerning the recent events in world financial markets. We’ve taken the opportunity to provide responses to the questions listed in the agenda material in the hope they will prove useful to you.

At whom should general purpose financial statements be primarily aimed and why? Should general purpose financial statements have a financial stability objective? Why or why not?

A general purpose standard *should* have a financial stability objective. There will often be more than one way to fulfill investor needs for information, and whether one or another is optimal will frequently be a subjective assessment, or the result of an incremental difference. At the same time accounting standards affect the behavior of preparers, investors and regulators, and the trends of those behaviors can have very significant affects on economic health and financial stability. Ill effects on financial stability will also damage investors directly and the economy in general.

The incrementally or theoretically “best” accounting standard for investors might engender behaviors on the part of preparers or investors that create systemic risks. A *different standard that provides sufficient information to investors, but is more supportive of economic health and financial stability* ought to receive very serious consideration. Hierarchies of decision criteria can be complex, and support of

Executive Chair
Jerry M. de St. Paer

Vice Chair
Michael E. Sproule
CFO
New York Life Insurance Company

Philip Bancroft
CFO
ACE Ltd.

Don Clivgin
CFO
The Allstate Corporation

David L. Herzog
SVP, Corporate Comptroller & CAO
American International Group, Inc.

David B. Greenfield
CFO
AXIS Capital Holdings Ltd.

Patrick B. Kelleher
CFO
Genworth Financial, Inc.

Beth Bombara
Controller
The Hartford

Fredrick J. Crawford
CFO
Lincoln Financial Group

Peter H. Rubenovitch
CFO
Manulife Financial

Sandra J. Peters
Corporate Controller
MetLife, Inc.

Albert Benchimol
CFO
PartnerRe Ltd.

Peter B. Sayre
Senior VP and Controller
Prudential Financial, Inc.

Fred R. Donner
CFO
RenaissanceRe Holdings Ltd.

Dale Egeberg
Controller
State Farm Insurance Companies

Richard P. McKenney
CFO
Sun Life Financial Inc.

D. Keith Bell
Senior VP, Corporate Finance
Travelers Companies, Inc.

Brian Nocco
CFO
XL Capital Ltd.

Douglas Wm. Barnert
Executive Director

GNAIE
Group of North American Insurance Enterprises
40 Exchange Place, Suite 1707
New York, NY 10005
UNITED STATES

+1-212-480-0808
info@insuranceaccounting.org
www.insuranceaccounting.org

financial stability and the needs of all stakeholders ought to be among the considerations placed into balance with the needs of investors.

“Fair value” (FV) as defined in the standards has become heavily model-driven, often at the detriment of judgmental considerations of what actually constitutes “fair value”. The implication that “fair value” information (as defined in the standards currently) is not biased is unsupported. It is biased toward the assumptions that:

- Only the most recent market price information is financially or economically relevant to the user;
- Short-term market fluctuations are relevant to the going-concern value of the entity;
- The holder’s intent (other than choice of exit market) has no impact on the economics of the balance sheet item;
- A hypothetical exit value is relevant in the absence of a functioning market¹.

These are issues that are not solely related to whether the accounting standards support financial stability. They are also issues as to whether the accounting standards are relevant, representationally faithful, understandable, etc. Pro-cyclicality may not only be an issue of concern with regard to financial stability. Pro-cyclicality may also be a symptom of the valuation standard’s undue sensitivity to short-term value changes that are not materially relevant to the economics of the reporting entity, when the economics are assessed using principled judgment.

With specific reference to fair value, should financial stability or pro-cyclicality be considered even if a loss of transparency of information would result?

There is no reason why provisions of the accounting standards put into place to dampen pro-cyclicality need to impair the transparency of information. Pro-cyclicality is (primarily) engendered by changes in market values affecting capital or income. The threat that future market drops will deteriorate the capital or income of the entity cause management to overreact to unsubstantiated information or short-term incremental price declines. A disclosure of un-adjusted fair value information that did not immediately run through profit and loss or would be a supplemental balance sheet disclosure would give the analyst the tools necessary to assess the values reported according to other bases, and have far less pro-cyclical effect.

The relevant question is whether a FV standard that requires a hypothetical, model-driven exit value

¹ Absent any guidance re-directing the valuation from FAS 157 in that case.

when no functioning market exists should be the sole basis of balance sheet and income reporting.
What principles should determine when financial instruments are carried at fair value and when changes in fair value should be included in profit or loss (earnings)?

Fair value, as defined in FAS 157, objectively represents the intrinsic value of a balance sheet item when an active, liquid, and orderly market exists. In the absence of an active, liquid, and orderly market, fair value tends to represent liquidation values that are not appropriate for financial statements presented on a going concern basis. Some analysts find disclosure of fair value information in disorderly circumstances useful, and we have no objection to presenting such information either as a supplement, or as disaggregated changes to other comprehensive income.

Intrinsic value can be defined in terms of the purpose of financial statements: the present value of the probable impact of the balance sheet items on the income of the entity reporting. The enhancing qualitative characteristics and constraints (verifiability, cost/benefit, etc.) should also inform decisions regarding the appropriate measurement basis.

What additional guidance, if any, is needed in the area of determining fair value?

The FV guidance releases by the FASB, IASB the IASB Expert Advisory Panel (EAP) and the SEC have failed to resolve the key issue of the role of infrequent transactions in inactive, illiquid and disorderly markets in estimating a hypothetical transaction price.

In addition a serious discussion needs to be held with constituents as to the performance of FV, particularly as defined in FAS 157, in this crisis. There has been little if any discussion on whether a *hypothetical exit price is relevant, reliable or comparable in inactive, illiquid and disorderly markets*, and what alternatives exist. The phrasing of this question avoids the issue.

We strongly suggest a quantitative study of the performance of FV measurements both before and after the crisis compared to actual cash flows and ultimate impact on the entities affected by the crisis. Alternatives should be studied as well.

As an example of an alternative, we continue to support our proposal for structured credit products, which we have presented in numerous comments and discussions. There should be a screen in FAS 157 to redirect the accounting for securitizations whose market becomes inactive, illiquid and disorderly from "fair value" to the accounting basis for the underlying assets.

With regard to "dynamic provisioning", valuation on a "through the cycle", portfolio basis sounds attractive (and familiar to insurance companies). We look forward to participating in further discussions to achieve an operational proposal. We do not believe that technical questions concerning implementation of the idea should preclude discussion of "dynamic provisioning" or any other



alternative to fair value. We feel that standard setters should undertake good faith efforts to answer the questions raised in the course of evaluating the appropriateness of the concept. In addition, we are concerned that requiring pro-cyclicality be addressed entirely by sector regulators may in the end increase the pressures for regulatory arbitrage.

Thank you for considering our comments. We will be listening with great interest to your call tomorrow. Unfortunately, I will not be able to attend, but GNAIE will be represented at the meeting by its Executive Director, Doug Barnert.

Please let me know if you have any questions or need additional information.

Sincerely,

A handwritten signature in black ink, appearing to read "Jerry de St. Paer". The signature is written in a cursive, flowing style.

Jerry de St. Paer
Executive Chairman

JdSP:wes