



American Insurance Association



Financial Security. For Life.

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LETTER OF COMMENT NO.

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Re: Proposed FASB Staff Position No. 157-d,
Determining the Fair Value of a Financial Asset in a Market That Is Not Active
File Reference: Proposed FSP FAS 157-d

The American Insurance Association (“AIA”) and the American Council of Life Insurers (“ACLI”) are pleased to provide the following comments with respect to the proposed FSP referenced above. The AIA is a leading property-casualty insurance trade organization, representing 350 insurers that write more than \$123 billion in premiums each year. The ACLI is a trade association whose 353 member companies account for 93 percent of the life insurance industry’s total assets in the United States, 93 percent of life insurance premiums and 94 percent of annuity considerations. Our member companies are major participants in the capital markets, holding trillions of dollars in investments. Thus, insurers are directly impacted by the issues addressed in this proposed FSP.

The application of FASB Statement No. 157 (“FAS 157”) has contributed to a series of actions that have now led to serious disruptions in the markets for certain securities. We support the efforts of both the Financial Accounting Standards Board (“FASB”) and the Securities and Exchange Commission (“SEC”) to provide additional guidance for applying FAS 157. The joint guidance issued on September 30, 2008, is useful in that it makes clear that when an active market for a security does not exist, the use of management estimates that incorporate current market participant expectations of future cash flows, including appropriate risk premiums, is acceptable. However, the proposed amendments of FSP FAS 157-d do not go far enough in providing practical, principled guidance that would allow companies to exercise sound judgment in the current market environment.

FAS 157 is a technical standard that uses a rules-based methodology for determining fair value. The proposed FSP appears to take a similar rules-based approach; and yet, it fails to add clarity to a fundamental question: what characteristics distinguish an active market from an inactive market? For example, in paragraph A32D, a company is advised to determine an appropriate discount rate after considering the “implied rate of return at the last date on which the market was considered active”. The FSP provides no definition of an “active” or “inactive” market; it provides no guidance for determining the “last date on which the market was considered active;” and it begs the question of how one can support a determination that a market is inactive when transactions are still occurring.

As a practical matter, there probably is no consistently reliable bright-line test for distinguishing between an active and inactive market. Hence, we believe a more principled approach is to provide guidance that acknowledges that a market consisting mostly of distressed sales will no longer reflect the fair value of the securities, other than for those securities that a company must sell.

The problem that has arisen in the financial markets is that insurers and other large institutional holders of certain securities have stopped trading certain securities because the market no longer reflects the underlying economic value of the securities. The few transactions that are occurring arise from market participants who must sell for such reasons as curing violations of debt covenants or meeting collateral requirements triggered by ratings downgrades. In effect, these transactions are occurring with participants who are being forced to liquidate certain holdings in a severely distressed market. According to paragraph 7 of FAS 157, these transactions are examples of observable market inputs that should not be used to measure fair value.

The apparent requirement in the proposed FSP to use this information in the determination of a fair value measurement would contradict the principles of FAS 157 and result in a liquidation measurement instead. It is an unintended consequence that could be imposed on investors because of a presumption that fair value must begin with observable market inputs, no matter how irrelevant or unreliable those market inputs may be¹.

Though the proposed FSP provides an example of an alternative approach for determining fair value in an inactive market (in paragraph 11, the present value technique is the alternative), the FSP requires a determination of a rate of return and an evaluation of various risks by referencing market inputs. The rationale of this approach is circular and locks the holder into an endless spiral that requires using market inputs from an inactive market in determining an amount that is presumed to be "fair value." While the example is intended to be an amendment to FAS 157, it basically reinforces the market participant view and does not provide meaningful and useful guidance to address the current, distressed market, for which market inputs are no longer relevant.

For securities that are held, distressed market values are not representative of the future cash flows to be received from the held securities, and are therefore of little use, other than in liquidation, when determining the future cash flows of the holder. We believe that when such a market occurs, the market participant view is no longer a faithful representation of economic value, and therefore should be secondary to professional judgment in the selection of the most appropriate method for determining the fair value in such circumstances.

In conclusion, the FSP is a reasonable interpretation of FAS 157, but it fails to provide new, meaningful or practical guidance that can be applied to current market conditions. There are basic contradictions in the guidance, e.g., FAS 157 is premised upon the concept of "orderly transactions between market participants", but orderly transactions do not occur in inactive, disorderly markets. The FSP continues to rely on the orderly transactions concept, which is contrary to the idea of inactive markets.

¹ As illustrated by the Center for Audit Quality whitepaper issued in October 2007 entitled, *Measurements of Fair Value in Illiquid (or less liquid) Markets*.

The current market has broken down to the point that one can no longer rely on market prices as market-based inputs for internal valuation models. Instead of the proposed FSP, FASB needs to provide principles-based guidance that does not rely on an assumption of orderly market transactions when such transactions, in fact, no longer exist.

Thank you for this opportunity to comment on the proposed FSP. Please feel free to call on us with any questions.

Sincerely,



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