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LETTER OF COMMENT NO. 48

June 18, 2007

Mr. Lawrence Smith
Director, Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 1530-100

Dear Mr. Smith,

FGIC Corporation appreciates the opportunity to comment on the Financial Accounting Standards Board ("FASB" or "Board") Exposure Draft of "Proposed Statement of Financial Accounting Standards, *Accounting for Financial Guarantee Insurance Contracts -- an Interpretation of FASB Statement No. 60*" (the "ED"). FGIC Corporation's principal operating subsidiary, Financial Guaranty Insurance Company ("FGIC"), provides triple-A credit enhancement on public finance, structured finance and asset-backed obligations in the U.S. and internationally. FGIC is a member of the Association of Financial Guaranty Insurers ("AFGI").

We commend the Board's efforts to improve the transparency and comparability of financial statements of insurance enterprises that issue financial guarantee contracts by clarifying the accounting and financial reporting for these contracts.

We understand that the project that has resulted in the issuance of the ED was added to the Board's agenda in response to Securities and Exchange Commission concerns regarding inconsistent methods of accounting for claim liability recognition and measurement within the financial guaranty insurance industry. We believe that the provisions of the ED related to claim liability recognition, measurement and disclosure address these concerns, and we generally agree with those provisions; the proposed claim liability accounting and disclosures will reduce diversity, provide more useful information to users of financial statements and improve transparency.

However, as discussed below, we disagree with certain key aspects of the proposed guidance related to unearned premium revenue and premium revenue recognition. We believe that the proposed guidance will increase complexity and diminish the relevance and transparency of financial reporting in these areas. This would be an unfortunate outcome, particularly given that revenue recognition practices in the financial guaranty industry have generally been consistently applied and are well understood by those that follow our industry. Moreover, in view of the FASB's stated intention to pursue a project to parallel efforts the International Accounting Standards Board ("IASB") to develop a new accounting model for all insurance companies, we urge the Board to consider excluding unearned premium revenue and premium revenue recognition from the scope of this project and perhaps revisit these topics as FASB and IASB pursue parallel standards.



We would appreciate the opportunity to further express our views at the open roundtable discussion scheduled for July 16. If you should have any questions about our comments in the interim, please do not hesitate to contact Nick Santoro, Controller, at 212-312-2716 or Nick.Santoro@fgic.com, or Donna Blank, Chief Financial Officer, at 212-312-3295 or Donna.Blank@fgic.com.

Our comments are set out below.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'D. Blank'.

Donna J. Blank
Senior Vice President and Chief Financial Officer

A handwritten signature in black ink, appearing to read 'Nick Santoro'.

Nick Santoro
Managing Director and Controller

General

General: This proposed Statement uses a new format in an effort to improve understandability of FASB documents. Do you believe the new format increases the understandability of this proposed Statement? What changes do you like? What changes do you not like? What additional improvements could be made to increase the understandability?

We generally found the new format to be useful and believe it increases understandability. The simplified examples in the text are helpful in understanding the point of the paragraph. We believe the format could be improved by providing more detailed examples.

Scope (Paragraphs 2–6)

Issue 1: The scope of this proposed Statement defines a financial guarantee insurance contract as a contract issued by insurance enterprises that provides protection to the holder of a financial obligation from a financial loss in the event of a default. The event of a default (insured event) refers to nonpayment (when due) of insured contractual payments by the issuer of the insured financial obligation. Do you agree with the definition used to identify a financial guarantee insurance contract subject to the provisions of this proposed Statement? If not, why not?

In general, we agree with the definition used to identify a financial guarantee insurance contract subject to the provisions of the ED. However, inasmuch as the ED scope specifically excludes contracts that are included within the scope of Statement of Financial Accounting Standards (“FAS”) 133, we believe that further guidance on the application of paragraph 10(d) of FAS 133 and a modification of paragraph 3 of the ED are needed in order to align the two statements. Specifically, paragraph 3 of the ED states as follows: “The holder of the financial guarantee insurance contract (policyholder) will vary. In some cases, the policyholder will be the issuer...In other cases the policyholder will be the holder of the insured financial obligation.” The preceding statement is not directly aligned with paragraph 10(d)(3) of FAS 133, which requires the guaranteed party to either have direct legal ownership of the insured obligation or indirect ownership, if the contract involves a back-to-back arrangement. The criteria set forth in paragraph 10(d)(3) would not be met in instances where the issuer is the policyholder since the issuer does not have legal ownership of the financial obligation.

We do not believe that this is the FASB’s intent and believe that alignment can be achieved by making reference to the beneficiary of the contract rather than the policyholder in paragraph 3 of the ED, and by issuing guidance on application of paragraph 10(d)(3) of FAS 133 indicating that the guaranteed party is the contract beneficiary.

Our suggested specific wording changes to paragraph 3 of the ED are as follows (additions underscored):

Financial guarantee insurance (and reinsurance) contracts are contracts issued by insurance enterprises that provide protection to the holder of a financial obligation (contract beneficiary) from a financial loss in the event of a default. Examples of such financial obligations include a municipal bond or an asset-backed security issued by a trust. The term of a financial guarantee insurance contract is the contractual term of the insured financial obligation regardless of the manner in which the premium is paid to the insurance enterprise (that is, a single premium at inception or in installments). The ~~holder~~ purchaser of the financial guarantee insurance contract (~~policyholder~~) will vary.

In some cases, the ~~policyholder purchaser~~ will be the issuer (for example, a municipality, a corporation, or a trust) of the insured financial obligation for the benefit of the holder 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 purchaser~~ 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.

Issue 2: This proposed Statement would apply to financial guarantee insurance (and reinsurance) contracts issued by insurance enterprises included within the scope of Statement 60. Do you agree with the scope of the proposed Statement? If not, why not? Should the scope include other insurance contracts that are similar to financial guarantee insurance contracts issued by insurance enterprises? Should the scope include all financial guarantee contracts (that is, those issued by insurance and noninsurance enterprises)?

We do not agree with limiting the scope of the proposed ED based on the type of enterprise. Rather, we believe that the scope of the ED should be based on type of contract, and should be expanded to include all financial guarantee contracts that meet the criteria of paragraph 10(d) of FAS 133. Limiting the scope of the ED to insurance enterprises would eliminate comparability between financial statements of insurance and non-insurance enterprises that, in substance, offer similar financial guarantee contracts.

Issue 3: The scope of this proposed Statement would not apply to a financial guarantee insurance contract that is a derivative instrument included within the scope of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. Should more guidance be provided regarding paragraph 10(d) of Statement 133 and how to apply that paragraph?

To date, limited guidance on the application of paragraph 10(d) of FAS 133 has been provided. As a result, various interpretations on how to apply paragraph 10(d) have emerged, leading to inconsistent financial reporting. We believe the FASB should take this opportunity to address the inconsistencies that have emerged by providing guidance in the following areas:

- Additional guidance is needed on the application of paragraph 10(d)(3) to address situations in which the issuer of a financial obligation purchases the financial guarantee contract. In these situations, determining whether or not the financial guarantee contract meets the 10(d)(3) criteria hinges upon whether the issuer or the holder of the insured financial obligation is the guaranteed party. As noted in our response to Issue 1, we believe that issuing guidance defining the guaranteed party as the contract beneficiary (regardless of whether that party is the purchaser) will eliminate existing differences in interpretation.
- In certain cases, financial guarantee contracts relate to a financial obligation with an embedded derivative, as defined in FAS 133 and FAS 155. FAS 133 does not address whether an enterprise is permitted to separate the portion of a financial guarantee contract related to the embedded derivative from the “host” financial guarantee contract when applying paragraph 10(d). We believe that including a statement similar to the language provided in paragraph 10(c) of FAS 133 (stating that certain insurance contracts that include both derivative portions and nonderivative portions are subject to paragraph 12 of FAS 133) would improve consistency in the accounting treatment of contracts with embedded derivatives within the financial guarantee industry.

Unearned Premium Revenue (Paragraphs 7–11)

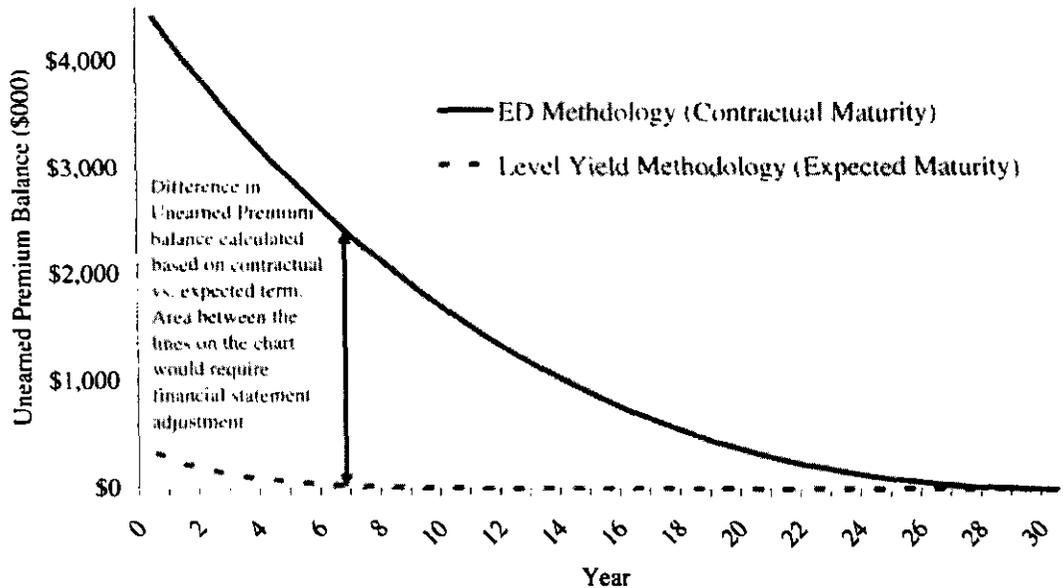
Issue 4: This proposed Statement would require that an insurance enterprise recognize a liability for unearned premium revenue at inception of a financial guarantee insurance contract. Further, a premium receivable (asset) would be recognized at inception of the financial guarantee insurance contract for which the premiums are received in installments (since each installment premium is not considered a renewal premium but merely a form of financing). Do you agree? If not, why not?

We do not agree with the concept of recording a premium receivable and a corresponding unearned premium reserve at inception of the financial guarantee insurance contract for premiums paid on an installment basis. Recording an installment premium receivable at inception is inconsistent with Concepts Statement No. 6, which defines assets as “probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events,” because the event that gives the insurance enterprise the right to the premium (coverage during the installment period) will not have occurred. An installment payment mode is merely a market convention tailored to the obligations where the timing of principal repayment is variable and uncertain. Typically, installment premium payments are calculated and paid to the insurer periodically based on the principal amount outstanding. Thus, the installment premium payment represents compensation for the service provided (insurance coverage) during the installment period. Installment premiums for future periods are not obligations of the issuer and should not be considered a form a financing.

Issue 5: Under this proposed Statement, the measurement of the initial unearned premium revenue (liability) would be the present value of the contractual premium due pursuant to the terms of the financial guarantee insurance contract. Further, for premiums received in installments, the initial measurement of the unearned premium revenue (liability) would be based on the present value of the contractual premium receivable (asset). Do you agree? If not, why not?

As noted in our response to Issue 4, we do not agree with the concept of recording a premium receivable and a corresponding unearned premium reserve at inception of the financial guarantee insurance contract for premiums paid on an installment basis. However, to the extent that the Board decides to require capitalization of future installment premiums, recording a premium receivable and unearned premium reserve based on total contractual premiums could materially overstate the assets and liabilities of a financial guarantor and in many cases, as is illustrated in the graph below, would not be representative of future premium collections/earnings. Recording the asset and liability based on expected, rather than contractual, premiums would be more appropriate.

Unearned Premium - Projected Amortization
 Contractual Vs. Expected for level amortization 30 year MBS transaction
 (Expected Assumes Pre-payments of 30%)



Issue 6: This proposed Statement would require that the present value of the premium receivable (asset) be determined using a discount rate that reflects the policyholder’s credit standing at the inception of the contract. The discount rate would be accreted on the premium receivable (asset) through investment income over the period of the contract in accordance with APB Opinion No. 21, Interest on Receivables and Payables. Do you agree? If not, why not?

As stated in our response to Issue 4, we do not view installment premiums as a form of financing. Therefore, we do not agree with the concept of accreting the discount through investment income. We believe that bifurcating installment premiums adds an unnecessary level of complexity for users and preparers of financial statements of financial guarantors, particularly when revenue for the discount accretion is recognized under the yield or interest method and premiums are recognized under a different method.

To the extent that, notwithstanding our view, the FASB implements a standard that bifurcates the premium and investment income components, we believe the language in paragraph 10 should be amended to state that the present value of the premium receivable should be determined using the discount rate that reflects the “credit standing of the policyholder party responsible for paying the premium at the inception of the contract.” As noted in our response to Issue 1, the purchaser (payer of the premium) of the policy and the policyholder are not always the same party. Further, the credit standing of an Asset-Backed Securitization (“ABS”) trust is not always a single measure. ABS trusts often issue several tranches of debt, each with its own credit rating. Therefore, we believe that language should be added to paragraph 10 of the ED stating that in the case of an ABS transaction where multiple tranches and credit ratings exist, the credit standing for purposes of determining the discount rate should be based on the priority of premium payments compared to the other obligations of the ABS trust.

Issue 7: This proposed Statement does not provide specific guidance related to changes in contractual premiums, such as changes due to interest rates on a floating-rate insured financial obligation or partial prepayments of an insured financial obligation. How often are floating-rate financial obligations insured by insurance enterprises within the scope of this proposed Statement? How often do partial prepayments of an insured financial obligation occur? Do you believe the Board should provide additional guidance for these changes in contractual premiums?

To the extent that, notwithstanding our view, the FASB requires the recording of an unearned premium liability based on contractual or expected installment premiums, we encourage the FASB to issue detailed guidance and examples on how to account for changes in expected future premium payments. In order to ensure that the assets and liabilities presented in an enterprise's financial statements are the best representation of anticipated results, we believe the amounts should be adjusted as new information becomes known. Use of the expected term will minimize the impact of adjustments needed to "true-up" balances, because experience has shown that the actual term will be much closer to the expected term than to the contractual term. By issuing guidance in this area, the FASB will minimize inconsistencies in financial reporting across companies.

Premium Revenue Recognition (Paragraphs 12–17)

Issue 8: This proposed Statement would require that an insurance enterprise recognize a premium from a financial guarantee insurance contract as revenue over the period of the contract in proportion to the insured contractual payments made by the issuer of the insured financial obligation. The premium revenue for each reporting period would be determined based on the ratio of (a) the insured contractual payments made on the insured financial obligation during the reporting period to (b) the total of all insured contractual payments to be made on the insured financial obligation over the period of the contract. During its deliberations, the Board considered measuring at fair value a financial guarantee insurance contract, noting that a fair value measurement would include changes caused by the passage of time. However, the Board did not pursue a fair value measurement because it is unwilling at this time to change to the fair value measurement attribute within the insurance accounting model for only one type of insurance contract. Do you agree with the proposed premium revenue recognition approach? If not, why not? Also, if not, what should be the appropriate determinant of revenue recognition?

We support the FASB's desire to develop a consistent revenue recognition model for financial guarantee insurance contracts regardless of the premium collection method (upfront or installment.) Based on deliberations at various FASB meetings which we have attended, and the background information provided in Appendix B to the ED, we believe that the FASB's intent was not to impose a fundamentally new accounting model but rather to provide a revenue recognition model that follows the general concept of the short-duration revenue recognition model established under FAS 60.

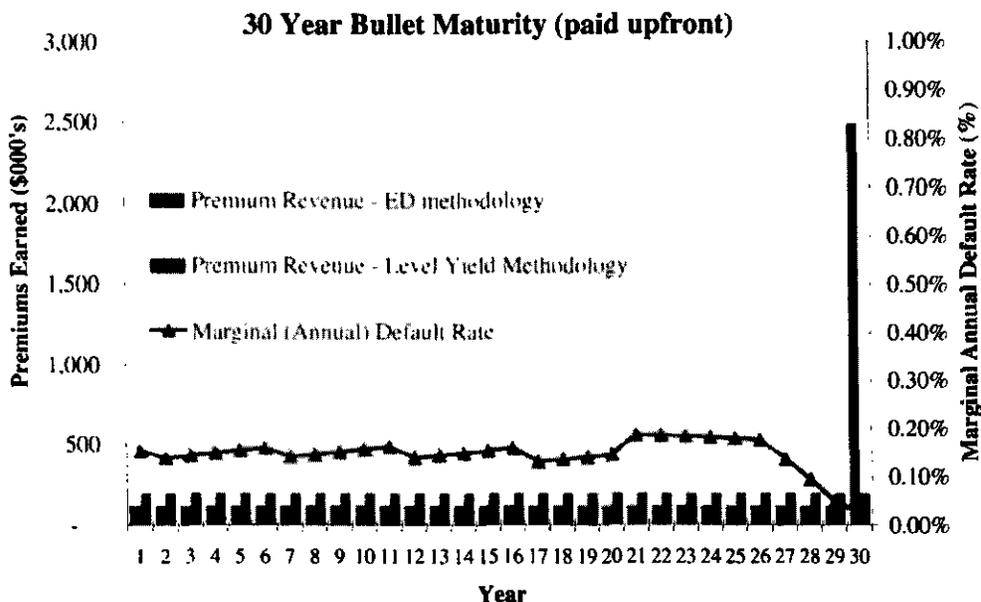
Under the model proposed in the ED, premium revenue would be determined based on the ratio of insured contractual payments made on the insured obligation during the reporting period to the total of all insured contractual payments to be made on the insured financial obligation over the contractual term. This model fails to recognize at least two factual and economic realities. First, by linking revenue recognition to contractual payments, the proposed revenue recognition model ignores the fact that the financial guarantor is providing insurance for the entire period during which the underlying obligation is outstanding regardless of whether a contractual payment occurs. In our view, this is a fatal flaw in that it fails to recognize revenue as service is provided. It is also inconsistent with the short-duration revenue recognition model established under FAS 60, in which revenue is recognized ratably over the contract period in proportion to the insurance protection provided.

Second, the proposed revenue recognition model ignores the passage of time. Each day or month that passes without occurrence of an insured event represents the expiration of some of the risk assumed by the guarantor. The fact that risk of default reduces as time passes is evident in the market pricing of financial guarantee contracts, where for example, the embedded premiums charged for a shorter-term obligation will be less than those for a longer-dated transaction, all other things being equal.

Rating agency default probability matrices similarly reflect the reduction of risk as time passes. The cumulative default frequencies published by the rating agencies are positively sloped, indicating that each year of the contract adds an element of incremental risk. In fact, in deriving the marginal annual default rates for each year from the cumulative data, the marginal rates are fairly constant over the life of the obligation, indicating that the relative level of risk each year is relatively stable.

In order to address the above shortcomings of the proposed ED revenue recognition model while continuing to try to achieve parallel revenue recognition methods regardless of payment terms, we suggest that the FASB adopt a level yield approach (based on the premium rate applied to the average principal for the period) for all policies, regardless of the method of collection. While we acknowledge that this approach will not specifically track the expiration of default risk for a given contract, we believe that this approach is consistent with the short-duration revenue recognition model established under FAS 60, as it recognizes revenue as service is provided to the policyholder. Further, it would recognize premium in income in a constant relationship with principal outstanding (i.e., the level of protection provided) and would be consistent with rating agency data that shows relatively constant annual default probabilities over the life of the transaction. In addition, this approach would facilitate consistency in the methodologies for recognizing earned premiums, investment income, and the proposed accretion of discount on installment premium.

The chart below compares premium recognition under the proposed exposure based methodology of the ED to a level yield methodology for a 30 year bullet maturity. The ED methodology shows premium recognition that is heavily weighted towards the end of the transaction, whereas the level yield is constant throughout the life of the transaction. The chart also illustrates the annual marginal default rate which has been derived from the cumulative corporate default rates for an A2 rated bond generated from data provided by Moody's Investors Service ("Moody's"). Moody's uses this type of data to assess the financial resources available to financial guarantors to meet potential portfolio risks. As you can see, the marginal default rate is fairly constant throughout the life of the transaction, ranging from 10-20 basis points per year until it drops at the end of the transaction, showing a pattern that is much more similar to a level yield methodology than the exposure based methodology proposed in the ED.



Issue 9: The Board concluded that insured contractual payments of the insured financial obligation are the most appropriate measure of exposure in a financial guarantee insurance contract. Do you agree? If not, why not? Also, if not, what would be a more appropriate measure of exposure and why?

We believe that principal outstanding, rather than contractual payments of a financial obligation, is the most appropriate measure of exposure in a financial guarantee contract, since principal outstanding represents the present value of the financial obligation at a given point. In addition, the use of this measure is consistent with the requirement to record loss reserves based on the present value of expected cash flows.

Issue 10: Under the guidance in this proposed Statement, premium revenue would not be recognized for an insured zero coupon bond until the insured contractual payments are made at maturity. Do you agree that the proposed premium revenue recognition approach sufficiently incorporates the passage of time? Why or why not? How are these insured financial obligations affected by the passage of time (that is, how does the premium charged for the financial guarantee insurance contract change over time and what is the ability to subsequently price the contract)? Please provide examples.

As noted in our response to Issue 8, we do not agree with the proposed revenue recognition model, as it does not recognize revenue as service is provided nor does it take into account the passage of time. These fatal flaws are highlighted when determining the earnings schedule for zero-coupon and bullet obligations. In both instances, premium earnings are heavily weighted towards the end of the transaction even though 1) insurance coverage is being provided throughout the life of the insured obligation and 2) each day or month that passes without occurrence of an insured event represents the expiration of some of the risk assumed by the guarantor.

The concept of time passage is also a component of the current model for financial instruments. For example in the case of a non-insured bond, a portion of the interest income an investor earns on the bond represents compensation for the investor's exposure to the bonds issuer's credit.

Unlike the proposed accounting for financial guarantee contracts, however, the investor in a bond is not required to defer revenue recognition until the principal and accrued interest are received at maturity. We believe the proposed approach would be a significant departure from this established model. Below is an analysis, based on actual bonds, of how the accounting under the ED would differ from that of the bearer of the credit risk in an uninsured bond.

Parity Bond Analysis

Demonstrate the difference in earning patterns when time passage is ignored for FG

Assumptions Description		CUSIP	Par Amount	Yield	Price	Rating	Coupon									
New York City Muni Water Rpt Auth Wtr and Sew Sys Rev	Uninsured	94970C/FD2	25,000,000	5.11%	96.349	AA+/A32	5.0%									
New York City Muni Water Rpt Auth Wtr and Sew Sys Rev	Insured	94970C/FR2	25,000,000	5.07%	96.942	AAA/A3a	5.0%									
FG Upfront Earnings								109,413								
								1998	1999 - 2003	2004 - 2008	2009 - 2013	2014 - 2018	2019 - 2023	2024 - 2026	2027	Total
Principal and Interest earnings of investor in Uninsured Bond								193,238	6,297,600	6,387,530	6,387,600	6,297,600	6,387,600	3,932,500	25,839,760	61,571,996
Investor in Insured Bond								193,238	6,297,600	6,387,530	6,387,600	6,297,600	6,387,600	3,932,500	25,839,760	61,571,996
Investor in Uninsured Bond								(482)	(19,113)	(19,113)	(19,113)	(19,113)	(19,113)	(11,458)	(7,698)	(109,413)
Less: Tie id difference due to FG Insurance Premiums								(760)	(30,867)	(30,867)	(30,867)	(30,867)	(30,867)	(18,432)	(15,124)	(176,895)
Less: Difference in yield due to couponizing																
Total for Insured Bond								191,959	6,257,600	6,337,500	6,337,600	6,257,600	6,337,600	3,902,500	25,839,760	61,285,106
Proposed FG insurer earnings								288	11,250	11,250	11,250	11,250	11,250	6,750	46,125	109,413
Impact of ignoring time								(194)	(7,863)	(7,863)	(7,863)	(7,863)	(7,863)	(4,718)	44,229	-
* Based on Exposure Draft earnings methodology																
Derivation of Calculation:																
Bond cash flows								56,722	6,250,000	6,250,000	6,250,000	6,250,000	6,250,000	3,750,000	25,825,000	60,784,722
Earnings rate								0.20%	10.28%	10.28%	10.28%	10.28%	10.28%	6.17%	42.18%	100.00%
Proposed FG insurer earnings								288	11,250	11,250	11,250	11,250	11,250	6,750	46,125	109,413

Issue 11: The Board concluded that the contractual period covered by the insured financial obligation should be used in determining the period over which premium revenue should be recognized. Do you agree? If not, why not? When prepayment information is available, should this information be used to adjust the contract term when a homogenous pool of underlying contracts exists and is measurable? If so, please provide examples of these arrangements and a description of how reliable prepayment estimates are.

As noted in our response to Issue 8, we believe that a level yield approach based on the average principal for the reporting period should be the basis for recognizing premium. To the extent that, notwithstanding our view, the FASB implements a revenue recognition model based on the term of the insured obligation, we believe the expected term and not the contractual term is the more relevant and appropriate metric for measuring expected premium and the period over which premium revenue should be recognized for financial guarantee insurance contracts paid on an installment basis.

The principal driver of the installment payment mode, particularly in the case of ABS transactions, is for the most part based the expectation that at inception these transactions will not remain outstanding for the full contractual term. We believe that the information needed to estimate the expected lives of these transactions is available. For example, models for estimating ABS prepayment projections such as the econometric and option adjusted models are readily available and are employed by capital market participants for determining fair value at issuance and subsequent dates.

Issue 12: In instances where the issuer of an insured financial obligation that had a nonrefundable premium retires an insured financial obligation before its maturity and replaces it with a new financial obligation, this proposed Statement would require that any unearned premium revenue (liability) related to that contract and associated deferred acquisition costs be immediately recognized as premium revenue and expense, respectively. Further, if the insurance enterprise insures the new financial obligation, the insurance enterprise would record a premium on the new financial obligation that is in a separate (standalone) transaction. If that premium differs from the premium actually charged, the difference would be recognized in current income. Do you agree? If not, why not?

We believe that the wording of paragraph 16 may lead to differing interpretations and applications. Specifically, the term “refunding” should be clarified to address both current and advanced refundings. In a refunding, an issuer issues debt (“refunding debt”) to finance the repayment of previously issued debt (“refunded debt”). The repayment of the refunded debt may either be immediate (a “current refunding” – i.e., within 90 days following the issuance of the refunding debt) or at some future time (an “advanced refunding”). An advanced refunding defeases the refunded debt either legally or economically. In both a legal and economic defeasance, the issuer irrevocably places cash or other high quality assets with an escrow agent in a trust to be used solely to make scheduled interest and principal payments, and the possibility that the issuer will be required to make future payments on that debt is remote.

Since the refunded debt is not actually repaid in an advanced refunding, the financial guarantee insurance contract is not terminated. Although the financial guarantee insurance contract is not terminated, we believe that the acceleration of premium revenue is appropriate in an advanced refunding so long as the assets placed in trust are direct obligations or obligations guaranteed by or backed by the full faith and credit of the U.S. Government, since the escrow arrangement and the quality of assets essentially eliminates the insurer’s risk of loss.

Our view is supported by the fact that under GASB Statements No. 7, Advance Refundings Resulting in Defeasance of Debt, and No. 23, Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities, as amended by Statement No. 34, a government entity is no longer required to reflect the refunded financial obligation on its balance sheet. In addition, under Article 69 of the New York State Insurance Law a financial guaranty insurance company is granted single risk limit relief provided that the securities placed in the trust qualify as eligible collateral.

Below are paragraphs 16 and 17 amended (additions underscored) to reflect the above comments.

16. In some cases, the issuer of an insured financial obligation will ~~retire~~ refund the insured financial obligation before its maturity and replace it with a new financial obligation. ~~That situation, referred to as a refunding, often occurs when interest rates decrease such that the insured financial obligation is replaced with a new financial obligation at a lower interest rate.~~ In a refunding, the repayment of the old debt may either be immediate (a current refunding) or at some future time (an advanced refunding). An advanced refunding defeases the old debt, either legally or in-substance. A legal defeasance occurs when debt is legally satisfied based on certain provisions in the debt instrument even though the debt is not actually paid. Debt is defeased in-substance if the issuer irrevocably places cash or other assets with an escrow agent in a trust to be used solely to satisfy scheduled interest and principal payments of the debt. In an advanced refunding, the possibility that the issuer will be required to make future payments on the refunded debt is remote.

17. ~~In a refunding situation, the financial guarantee insurance contract on the retired financial obligation is terminated. Upon a refunding (current or advanced), the insurance enterprise shall immediately recognize any nonrefundable unearned premiums revenue (liability) related to that contract as premium revenue and any associated acquisition costs previously deferred under paragraph 29 of Statement 60 as an expense. Upon an advanced refunding, the insurance enterprise shall immediately recognize any nonrefundable unearned premiums revenue (liability) related to that contract as premium revenue and any associated acquisition costs previously deferred under paragraph 29 of Statement 60 as an expense, provided that escrowed funds are direct obligations or obligations guaranteed by or backed by the full faith and credit of the U.S. Government.~~ If the insurance enterprise insures the new financial obligation, the insurance enterprise shall recognize the unearned premium revenue (liability) on the new financial obligation commensurate with the premium it would charge to insure a similar financial obligation in a separate (standalone) transaction. If that premium differs from the premium actually charged, the differences shall be recognized in current income.

Claim Liability (Paragraphs 18–24)

Issue 13: This proposed Statement would require that an insurance enterprise recognize a claim liability on a financial guarantee insurance contract when the insurance enterprise expects that a claim loss will exceed the unearned premium revenue (liability) for that contract based on expected cash flows rather than when a default (insured event) occurs. Do you agree? If not, why not? Does this provide an appropriate point of recognition for a claim liability related to a financial guarantee insurance contract?

We do not agree that a claim liability should only be recognized when the insurance enterprise expects that a claim loss will exceed the unearned premium revenue for that contract. The concept of the unearned premium reserve representing the “stand-ready” obligation is a portfolio approach (e.g. premium deficiency reserve) and is not aligned with the proposed a contract-by-contract claim liability recognition model. We also believe that linking revenue and loss accounting is not appropriate given the FASB’s decision to approach revenue recognition in the context of the short-duration accounting model and claim liability recognition in the context of the long-duration accounting model. In our view, a claim recognition model linked only to the occurrence of credit deterioration provides a more accurate assessment of losses and will be better understood by users of our financial statements.

We believe the provisions of the ED addressing claim recognition measurement can be put into practice provided that the objective of paragraphs 20 – 21 is clarified. We are concerned that some might interpret the ED as requiring a specific calculation approach and minimum documentation, for example including some minimum number of scenarios regardless of how much meaningful information is actually available. We note that Paragraph 51 of Concepts Statement 7, Using Cash Flow Information and Present Value in Accounting Measurements, notes that the application of the expected value method is subject to a cost benefit constraint depending in part on how much information is available. We would encourage the Board to make its intent clear.

Although we believe that the provisions of the ED relating to claim measurement can be put into practice to provide a level of consistency of financial reporting across the industry, the more appropriate trigger for initial claim recognition, in our view, is credit impairment. Typically, credit impairment occurs prior to an insurance enterprise projecting negative cash flow, and reflects a substantial increase in the probability of default for a credit relative to the credit risk that was originally underwritten.

The measurement of a claim liability upon impairment would be based on the estimated probability of default and loss severity given default based on historical trends and other factors. Upon default or expected default, the claim liability for the impaired credit would be remeasured based on the net present value of expected cash flows.

We recognize that detailed disclosures outlining an enterprise's approach to recognizing an impaired loss would be needed in order to maintain financial statement transparency and comparability. However, we believe that recording an initial claim liability upon credit impairment combined with detailed disclosures will provide users of our financial statements with more useful information concerning the credit profile of the insured portfolio.

Issue 14: This proposed Statement would require that an insurance enterprise measure a claim liability based on the present value of expected cash flows discounted using a risk-adjusted rate at the time of the initial recognition of the claim liability. For purposes of this proposed Statement, that risk-adjusted rate shall be based on the risk-free rate, adjusted for the credit standing of the insurance enterprise. The discount rate would be updated only when a default occurs. Do you agree? If not, why not?

As noted in our response to Issue 13, we believe that an insurance enterprise should initially record a claim liability upon credit impairment. Since the initial claim liability would be recorded prior to projecting negative cash flows, a present value measurement concept would not be appropriate, and the liability would be recorded based on probability and severity factors rather than a cash flow projection. Upon an expectation of default, we believe that, 1) the claim liability should be the present value of expected cash flows using a discount rate that reflects the credit standing of the insurance enterprise at the measurement date and 2) the discount rate should be updated only when the actual default occurs.

Issue 15: This proposed Statement would require that in measuring the expected cash flows of the claim liability, the expected cash flows be developed using the insurance enterprise's own assumptions about the likelihood of all possible outcomes based on all information available to the insurance enterprise and those assumptions be consistent with the surveillance list maintained by the insurance enterprise. Do you believe that the surveillance list maintained by the insurance enterprise should affect the measurement of the claim liability? If not, why not and what alternative approach could be used? Do all insurance enterprises maintain a surveillance list and, if so, is the Board's understanding of the maintained surveillance list (as described in paragraph B21) accurate? Do you believe the Board should provide additional guidance about the surveillance list and what it contains? Can (or should) insurance enterprises follow the claim liability approach in this proposed Statement for financial guarantee insurance contracts not included on the surveillance list?

We support the FASB's view that an insurance enterprise's claims liability should be consistent with the surveillance list maintained by the enterprise. In general, the FASB's understanding of the maintained surveillance list as described in paragraph B21 is consistent with FGIC's surveillance list. However, as noted in our response to Issue 13, FGIC currently records a claim liability upon credit impairment. The measurement of the claim liability upon impairment is based on probability and severity factors rather than a cash flow projection.

Disclosures (Paragraphs 25 and 26)

Issue 16: This proposed Statement would require that specific disclosures be provided about (a) premium revenue recognition accelerated due to early retirement of the insured financial obligation, (b) financial guarantee insurance contracts for which premiums are received in installments, (c) the future contractual runoff of the unearned premium revenue (liability), and (d) the surveillance list used to recognize and measure claim liabilities. Do you agree? If not, why not? Do you believe these disclosures will assist financial statement users in better understanding the financial information for insurance enterprises that issue financial guarantee insurance contracts?

We agree with the majority of the specific disclosures outlined in the ED and believe these disclosures will improve the transparency and comparability of financial information already being disclosed in other forums. With regard to the recommended disclosure on runoff of unearned premium, we would recommend that the disclosure provide the expected runoff, rather than the contractual runoff.

Effective Date and Transition (Paragraphs 27–30)

Issue 17: The final Statement is expected to be issued in the third quarter of 2007. The Board concluded that this proposed Statement should be effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted. Do you agree with the Board's conclusions on the effective date? If not, what would be a reasonable period of time for implementation for applying the provisions of this proposed Statement? Also, if not, please provide a description of the process changes necessary to implement this proposed Statement that would require additional time.

We do not agree with the FASB's conclusion as to the effective date. There are numerous issues as to which the ED requests comment that could result in significant changes and/or clarifications of the guidance provided. Therefore, it is not cost efficient to begin implementing significant process changes until the proposed ED is final. Once it is final, sufficient time will be needed to allow us to develop, adapt, and test systems and processes to ensure compliance. Specifically, in order to implement this proposed ED, our policy capture and financial reporting systems will need to be redesigned to 1) calculate and earn the present value of contractual premiums over the contractual term; 2) bifurcate and calculate investment income to be accreted; 3) incorporate changes in contractual premiums due to prepayments; and 4) establish a process for incorporating the unearned premiums into the claim liability calculation. We estimate that the changes to our system will take approximately nine months in order to allow sufficient time for development, implementation and testing. It is also our understanding that other industry participants face similar challenges. Therefore, we recommend that the effective date of the proposed ED 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 ED.

Issue 18: This proposed Statement would require that an insurance enterprise recognize the cumulative effect of initially applying this proposed Statement as an adjustment to the opening balance of retained earnings for that fiscal year. Retrospective application is not permitted. Do you agree with not permitting retrospective application? If not, do you believe that retrospective application is possible and that sufficient information exists so that hindsight would not be used or required in reporting prior-period balances?

We agree with not permitting retrospective application. We encourage the FASB to provide detailed examples on calculating the cumulative effect of initially applying the ED.