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RE: Proposed FASB Staff Position – Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1 – *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* (FSP EITF 03-1-a or EITF 03-1).

Mr. Smith,

The Chief Financial Officers of eleven leading insurance companies including life insurers, property and casualty insurers, and reinsurers formed the Group of North American Insurance Enterprises (GNAIE) in 2003. GNAIE members include companies who are the largest global providers of insurance and substantial multi-national corporations. All are major participants in the US markets. The goal of GNAIE is to influence international accounting standards to ensure that they result in high quality accounting standards for insurance companies and, to that end, to increase communication between insurers doing business in North America and the International Accounting Standards Board (IASB) and the United States Financial Accounting Standards Board (FASB). GNAIE works to meet its goals through modeling of proposed accounting standards, analysis, comment, and coordination with various end users of financial reports

We are writing in response to FSP EITF 03-1-a and issues that arose during the FSP EITF 03-1-b comment letter process. We believe we share a common objective in ensuring reporting entities recognize impairments that are other-than-temporary in a timely manner consistent with the guidance in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115) and SEC Staff Accounting Bulletin No. 59, *Accounting for Noncurrent Marketable Equity Securities* (SAB 59) while not encouraging the pre-emptive recognition of impairments in a manner inconsistent with the beliefs and intent of management for the sole purpose of preserving the ability to sell securities in the future without the threat of triggering a tainting event. To achieve our common objective, we propose expanding the paradigm set forth in EITF 03-1 which would maintain conformity with both FAS 115 and SAB 59, accounting standards that are very well aligned with how reporting entities manage their investment portfolios, and allow reporting entities to account for temporarily impaired available-for-sale (AFS) securities in a manner consistent with their intent. The paradigm would recognize other-than-temporary impairments at the time a loss becomes probable based on the investor's intent, and consistent with the AFS designation in FAS 115, reporting entities would be permitted to change their intent to hold temporarily impaired AFS securities to recovery or maturity as long as the change in intent is adequately supported by a change in facts and circumstances consistent with the AFS designation.

Due to the complexity of this subject, there are a number of related topics that we would like to bring to the Board's attention that we believe require additional deliberation. The topics are enumerated below and discussed in more detail in the balance of this letter.

- Application of EITF 03-1 to securities that fall within the scope of paragraphs 10 and 16;
- "Minor" impairments;
- Impairments caused by increases in interest rates and/or sector spreads and the practicality of decomposing impairments into their three basic elements (i.e. that which is caused by increases in interest rates, that which is caused by increases in sector spreads, and that which is caused by entity specific factors);
- The "intent and ability" to hold temporarily impaired AFS securities until recovery;
- Recognizing pre-emptive write-downs of securities a reporting entity believes are temporarily impaired and intends to hold to recovery only to preserve the ability to sell such securities in the future without the threat of tainting;
- Designating or re-designating AFS securities as Trading to preserve the ability to sell securities in the future without the threat of tainting; and
- Effective date of the new authoritative guidance.

Application of EITF 03-1 to securities (equity and fixed income) that fall within the scope of paragraphs 10 and 16

It is our basic belief that any new authoritative guidance developed to allow reporting entities to determine when impairments are temporary or other-than-temporary should be equally applicable to securities that fall within the scope of paragraphs 10 and 16 of EITF 03-1. The primary distinguishing attributes of fixed income securities that fall within the scope of paragraph 10 are that they were purchased at a significant premium and/or can be contractually repaid or otherwise settled in such a way that the investor would not recover substantially all its cost. It is our belief that these attributes do not preclude paragraph 10 securities from becoming "temporarily" impaired (similar to securities that fall within the scope of paragraph 16) as a result of increases in interest rates and/or the widening of sector spreads and any other reasons that may arise. Accordingly, although the temporary impairment indicators may need to be expanded, we see no reason to apply inconsistent accounting guidance to fixed income securities falling within the scope of paragraphs 10 and 16 of EITF 03-1.

We also believe that appropriate guidelines should be developed for determining when equity securities are temporarily impaired. Although changes in interest rates and/or the widening of sector spreads have historically been shown to impact the value of equity securities we believe that other factors such as normal periodic market volatility is a more appropriate indicator of impairment that may be considered temporary. Moreover, we believe sufficient historical evidence exists to support that normal market volatility provides reasonable substantive support for a conclusion that impairments that are not sustained, severe, or caused by material entity specific factors can be considered temporary.

As a final point, with respect to the scope of paragraphs 10 and 16, we believe the Board should provide more definitive guidance on how to distinguish between fixed income securities that fall within the scope of paragraph 10 and paragraph 16. It is our belief that the majority of fixed income securities fall within the scope of paragraph 16, however, we believe there may be inconsistent interpretations of the phrase "debt securities that can be pre-paid or otherwise settled in such a way that the investor would not recover substantially all its cost". More specifically, Example 5 makes no reference to an assessment of the value of collateral and is therefore unclear as to whether asset-backed securities fall within the scope of paragraph 16 unless they were purchased at a significant premium in which case they would fall within the scope of paragraph 10.

"Minor" impairments

We believe minor impairments should be considered temporary and that there should be no "bright line" threshold for determining what constitutes a minor impairment as we believe the concept of minor is dependent upon the attributes of individual classes of securities. In addition, we believe the concept of minor impairments should apply <u>equally</u> to fixed income and equity securities as it would not appear to be cost beneficial to require reporting entities to analyze the impact of minor market fluctuations on equity securities. Moreover, while we advocate avoiding bright line thresholds in favor of the use of well reasoned judgments we believe reporting entities should be required to adequately substantiate their judgments with respect to impairments they deem temporary.

Impairments caused by increases in interest rates and/or sector spreads

Although we believe impairments caused by increases in interest rates and/or sector spreads can, under certain circumstances, be determined to be temporary we believe it would be wholly impractical to require reporting entities to separate impairments into their three basic components (i.e. that which is caused by increases in interest rates, that which is caused by increases in sector spreads, and that which is caused by entity specific factors) at each reporting period. Moreover, our understanding of the proposed guidance is that if any element of the impairment were attributable to entity specific factors, regardless of materiality, the impairment would not be eligible for the automatic designation as temporary. Accordingly, as it is generally expected that some portion of any impairment (excluding U.S. Treasuries and similar securities) is caused by entity specific factors (regardless of their materiality), the practicality of the model proposed in FSP EITF 03-1-a is unclear.

In contrast to the model proposed in FSP EITF 03-1-a, we believe impairments (both equity and fixed income) may be considered temporary for reasons that extend beyond increases in interest rates and/or sector spreads (e.g. non-material entity specific factors). More specifically, it is our belief that when determining whether an impairment is temporary or other than temporary reporting entities should analyze the following suggested criteria:

- Length of time and extent to which the market value has been less than cost;

- The financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential;
- The intent and ability of the investor to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value; and
- The short-term expected volatility of the class of security under consideration.

We believe the above criteria is consistent with both FAS 115 and SAB 59 and if applied to either equity or fixed income securities would result in the designation of an impairment as temporary in situations where the investor has the both the intent and ability to hold the security to recovery and the impairment is minor in terms of amount and duration and there are no material entity specific factors to suggest otherwise.

The "intent and ability" to hold temporarily impaired AFS securities until recovery

Designation of the intent to hold temporarily impaired securities until recovery is the cornerstone of the impairment guidance in FAS 115. Our proposed paradigm would retain and further expand the importance of the intent designation by requiring reporting entities to recognize other-than-temporary impairments whenever it is probable that a loss has been incurred based on the reporting entity's absence of intent to hold temporarily impaired securities to recovery. We believe this proposed standard is consistent with the International Accounting Standards Board's existing guidance regarding other-than-temporary impairments, as that guidance does not consider the concept of "tainting". Accordingly, we believe our proposed paradigm is consistent with the Board's objective to obtain convergence with International Accounting Standards. Moreover, we believe that with respect to the issue of "intent" to hold temporarily impaired AFS securities, FAS 115 does not preclude changes in intent that are caused by changes in facts and circumstances consistent with the AFS designation as that would effectively create a new "quasi" held-to-maturity category of securities. With respect to SAB 59, we note that it was disseminated before the issuance of FAS 115 and therefore did not specifically contemplate the creation of the AFS category. Accordingly, we believe that SAB 59 should reasonably be applied within the context of the available designations provided in FAS 115. More specifically, for temporarily impaired AFS securities, an investor should be able to designate, consistent with the guidance in FAS 115, an intent to hold "temporarily impaired" securities to recovery and later re-designate that intent, without triggering a tainting event, <u>as long as the change in intent is caused by a change in facts and circumstances consistent with the AFS designation and appropriately documented</u>. In contrast, if a change in intent is not supported by a change in facts and circumstances, the change should be evaluated with any other unsupported changes in intent in determining if a pattern of behavior exists which calls into question a reporting entity's designated intent to hold temporarily impaired securities to recovery.

Changes in facts and circumstances that we believe support a change in intent are those set forth in paragraphs 9 and 10 of FAS 115 as follows:

- Changes in market interest rates and related changes in a security's prepayment risk

- Needs for liquidity (for example, due to the withdrawal of deposits, increased demand for loans, surrender of insurance policies, or payment of insurance claims)
- Changes in the availability of and the yield on alternative investments
- Changes in funding sources and terms
- Changes in foreign currency risk
- Asset-liability management

We believe the changes described above are consistent with the way AFS portfolios are managed. Moreover, we believe the dynamic nature of both liquidity needs and asset-liability management (as well as other factors) requires investors to retain the ability to sell all classes of securities in the future, as to forgo that right could significantly impair the economic value of the reporting entity. In contrast, if the FASB were to directly or indirectly eliminate the AFS distinction for temporarily impaired AFS securities by narrowly defining the situations where a change in intent is permissible (e.g. significant and unexpected changes in liquidity, interest rates, and or credit sector spreads) we believe the result would be the recognition of "pre-emptive" write-downs and/or the re-designation (to the extent permitted) of securities to "trading" (the consequences of both are discussed more fully below). It is our belief that both alternatives would result in the adoption of accounting models that are inconsistent with the spirit and intent of FAS 115 as well as the spirit and intent of management, and therefore the factors that could lead to their adoption should be eliminated.

Recognizing pre-emptive write-downs of securities a reporting entity believes are temporarily impaired and intends to hold to recovery only to preserve the ability to sell such securities in the future without the threat of tainting

Reporting entities have an economic need, not just a desire, to maintain the flexibility to sell all classes of securities in response to changes in facts and circumstances consistent with the FAS 115 AFS designation. Accordingly, if the AFS designation is eliminated or otherwise curtailed to the point where a change in intent cannot be re-designated due to reasonable changes in facts and circumstances (defined as the criteria set forth in paragraphs 9 and 10 of FAS 115) without the threat of tainting, reporting entities would likely resort to "pre-emptive" write-downs. It is important to note that pre-emptive write-downs are not pre-mature write-downs of securities but rather write-downs of securities that a reporting entity has the current intent and ability to hold to a forecasted recovery but nonetheless recognizes an other-than-temporary impairment solely to preserve the ability to sell the securities in the future due to reasonable changes in facts and circumstances consistent with the AFS designation without the threat of tainting.

In the event pre-emptive write-downs are recognized, the affected securities would be written down, however, due to the reporting entity's belief that the cost of the security is fully recoverable, the amount of the write-down would immediately begin to be accreted into investment income pursuant to the guidance in SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3). This accounting consequence would be undesirable as it would lead to a distortion of both realized capital losses and investment income and would not allow financial statement users to accurately assess either credit trends or trends in investment income and any associated margin analyses.

Consistent with the above, we believe the direct or indirect elimination of the AFS designation for temporarily impaired securities could significantly impair the usefulness and representational faithfulness of financial statements inasmuch as it may cause reporting entities to take actions (e.g. pre-emptive write-downs or a re-designation to trading, to the extent permitted) that are inconsistent with their intent and thereby lead to a reporting of investment transactions in a manner that reflects neither the economic intent of management or the economic reality of the transactions. It is our belief that the issuance of any accounting standard that results in the encouragement of pre-emptive write-downs would also result in uneven accounting similar to LOCOM as losses would be realized through the income statement while gains would not. Moreover, we would also point out that in addition to impairing the usefulness of financial statements, pre-emptive write-downs are also inconsistent with FAS 115 which concluded very definitively in paragraph 97 that LOCOM accounting is uneven-handed and undesirable.

Designating or re-designating AFS securities as Trading to preserve the ability to sell securities in the future without the threat of tainting

If the FASB agrees that re-introducing a LOCOM-like standard is undesirable but at the same time either directly or indirectly eliminates the AFS designation for temporarily impaired AFS securities, it should allow reporting entities the opportunity to re-designate AFS securities (debt and equity) to trading without triggering a tainting event. Although a trading designation would also be undesirable as it would also be inconsistent with the intent of the investor (i.e. it would not be the intent of the investor to trade temporarily impaired securities in a manner designed to take advantage of short-term market movements), it would be preferable inasmuch as it would recognize both gains and losses, in contrast to the distortions that would accompany pre-emptive write-downs.

As a result of the preceding, we believe the FASB should retain use of the AFS designation for temporarily impaired AFS securities and allow reporting entities to sell temporarily impaired securities provided the sale is executed pursuant to the criteria set forth in SFAS 115 for AFS securities. However, if the Board decides to eliminate the use of the AFS designation for temporarily impaired AFS securities then it should allow at least a one-time re-designation of debt and equity securities to trading (without risk of tainting) as this would be superior to the LOCOM-like accounting that would otherwise likely emerge.

The effective date of the new authoritative guidance

Although this is the last item we will address we view it as one of the most important given the litigious environment we operate in together with the market's expectation of an exceedingly high degree of precision in the preparation of financial statements. That is, depending on the nature of the final guidance, sufficient time should be given to reporting entities to implement the necessary systems and process changes to enable the appropriate implementation of the new standard. The amount of time given to reporting entities should be commensurate with the magnitude of changes necessary to current processes. For example, if the guidance either directly or indirectly eliminates use of the AFS designation for temporarily impaired AFS securities and thereby leads to "pre-emptive" write-downs or adoption of a trading designation, we believe reporting entities would need at least six to twelve months to implement appropriate process and systems changes to distinguish the affects of "pre-emptive" write-downs (and related yield adjustments related to the implementation of SOP 03-3) or realized gains and losses from that which would have been reported as investment income and realized gains and losses prior to implementing the new guidance. It is our understanding that financial statement users such as rating agencies and investment analysts have suggested a need for such information.

In short, we believe that FAS 115 and SAB 59 provide an appropriate, well tested framework, for the determination of impairments as temporary or other-than-temporary. Accordingly, we urge the FASB to consider the proposed framework set forth in this letter which retains the fundamental guidance in both FAS 115 and SAB 59 and requires reporting entities to adequately substantiate their judgments while at the same time does not encourage reporting entities to account for securities in a manner that is inconsistent with both the spirit and intent of SFAS 115 and their own intent.

We appreciate your consideration of these issues.

Sincerely,

Douglas Wm. Barnert

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