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DAte Received:

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

RE: Proposed FASB Staff Position TB 85-4-a, Accounting For Life Settlement Contracts By Investors

Dear Mr. Smith:

American International Group, Inc. (AIG) appreciates the opportunity to respond to the Financial Accounting Standards Board (FASB or the Board) on the proposed FASB Staff Position TB 85-4-a, *Accounting For Life Settlement Contracts By Investors* (the Proposed FSP). AIG commends the Board on its decision to consider revisions to the accounting for life settlements. We agree that current guidance (FASB Technical Bulletin No. 85-4, "Accounting for Purchases of Life Insurance") is not appropriate for the investing activity in which a life settlement provider is engaged, but we do have some concerns about the Proposed FSP, which are discussed in the paragraphs below.

AIG is the world's leading international insurance and financial services organization, with operations in more than 130 countries and jurisdictions. AIG member companies serve commercial, institutional and individual customers through the most extensive worldwide property-casualty and life insurance networks of any insurer. In the United States, AIG companies are the largest underwriters of commercial and industrial insurance and AIG American General is a top-ranked life insurer. AIG's global businesses also include financial services, retirement services and asset management. AIG's financial services businesses include aircraft leasing, financial products, trading and market making. AIG's growing global consumer finance business is led in the United States by American General Finance. AIG also has one of the largest U.S. retirement services businesses through AIG SunAmerica and AIG VALIC, and is a leader in asset management for the individual and institutional markets, with specialized investment management capabilities in equities, fixed income, alternative investments and real estate.

AIG concurs that the cost accumulation / investment method (as described in ¶5 of the Proposed FSP) provides an improvement in financial reporting standards and is more closely aligned with the economic substance of the life settlement transaction than Technical Bulletin 85-4. However, we ask the Board to reconsider its decision to require the investment method for life settlement financial reporting in certain instances.

We believe the Effective Yield Method (EYM) should be permitted when providers accumulate a large and credible portfolio of life settlement obligations. The EYM would treat the investment in life settlement contracts in a manner that is consistent with the accounting model prescribed by SFAS 91 and other accounting literature. We note that SFAS 91 paragraph 19 already acknowledges a different accounting that can be applied when an enterprise holds a large number of similar loans.

The Effective Yield Method has several advantages over the investment method. For one, application of the investment method recognizes income at the very end. While the investment method would result in a more conservative recognition of income, changes in expectations would not be recognized under this method. Rather, the EYM has the effect of recognizing these changes over time while dampening any measurement bias.

The Board also considered, but did not accept, fair value as the relevant measurement attribute for life settlement contracts because the Board did not believe that the fair value subsequent to the date that the life settlement contract could be reliable determined. We understand that the fair value hierarchy currently considers a wide range of estimates of fair value and acknowledge that for certain financial instruments (e.g. derivatives) significant entity inputs which may or may not be readily available are used during modeling. Therefore, we believe that the EYM is another example of fair value that is consistent with the Board's recent deliberations. Accordingly, concerns over reliability should not be an issue. The trade-off between relevance and reliability should not be all or nothing. For sufficiently large homogenous portfolios, statistics have shown that measurements can be reliably determined. The application of the Effective Yield Method, which has its grounding in accounting literature, for a homogenous pool of similar type of obligations would in our view represent an improvement in financial reporting.

Effective Yield Method

The implementation of the Effective Yield Method would follow the template laid out in ¶19 of SFAS 91. Where the financial institution considers prepayments in the determination of the effective yield of a loan portfolio, the life settlement provider considers mortality.

(i) For financial reporting purposes, the block of business is segregated into subportfolios by year of issue (or some other appropriate period).

(ii) For each contract within the subportfolio, initial and continuing costs and expected death benefits are projected over the contract's entire benefit period. The projection is done on an individual policy basis using each insured's age, gender, and mortality classification.

(iii) The individual policy projections are aggregated and the effective yield for the subportfolio is calculated.

(iv) Actual costs and death benefits will differ from those originally projected. This may cause the life settlement provider to modify their assumptions for future mortality. The effective yield will be recalculated periodically to reflect variations of prior actual cash flows from those expected and as well as changes in anticipated future cashflows.

(v) The carrying value of the subportfolio would be adjusted to the amount that would have existed had the new effective yield been applied since inception.

AIG believes that the investment method should apply when the number of contracts acquired by the life settlement provider is small. Users of financial statements should not rely on estimates of liability cash flows in this case, because such estimates cannot be statistically credible and verifiable.

Life settlement providers, however, that have acquired a relatively large portfolio of such liabilities do rely on emerging mortality experience from this business to form credible and relevant estimates of future cash flows. In this case we believe it would be useful to potential investors for life settlement companies to measure life settlement assets and accrete earnings under the Effective Yield Method.

Under the investment method, for a portfolio of paid-up contracts with average life expectancy at purchase of 10 years, the carrying value would be similar to purchase price. This is reasonable at the purchase date, however after 8 years for example, the carrying value would not be a fair representation of the fair value of the portfolio. Conversely, if expectations have become overstated, that information would also need to be reflected. Accordingly, we believe that a more representationally faithful amount would approximate an amount recorded under the Effective Yield Method, which would reflect both good and bad news in the carrying value of this investment. Further, this method more closely aligns with the Board's recent efforts on fair value.

The ability to collect information on the mortality status of <u>individual</u> members of a life settlement portfolio is hampered by health privacy regulations and other constraints. However, as the owner and manager of a <u>portfolio</u> of liabilities, life settlement providers have access to valuable information on similar lives. Like a direct insurer, the life settlement provider performs statistical comparisons of actual mortality to that expected at the transaction date. This information may be applied to set acquisition criteria for new life settlement transactions.

Many aspects of insurance accounting are under fundamental review and reconsideration, both at FASB and IASB. A "cross cutting issue" is unit of account. We believe that the right unit of account for retail life insurance is the portfolio of liabilities. This issue will certainly come up in the conceptual framework project. Ultimately we expect to see statistical concepts apply in both recognition and measurement.

We encourage the Board to reconsider the application of the Effective Yield Method for life settlement accounting when the size and other characteristics of the liability portfolio permit credible mortality estimates.

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As you move forward with the final issuance of this Proposed FSP we hope that you will consider our views and recommendations. If you have any questions please contact myself, or Anthony Valoroso at 212-770-6463 regarding the contents of this letter. We would be pleased to discuss our comments with the Board or the FASB staff at your convenience.

Very truly yours,

David L. Herzog