October 5, 2006

LETTER OF COMMENT NO. 9

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Subject: FASB Statement No. 155: *Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140*

Dear Technical Director:

The American Council of Life Insurers and the Group of North American Insurance Enterprises appreciate the opportunity to comment on FASB Statement No. 155 *Accounting for Certain Hybrid Financial Instruments.*

The American Council of Life Insurers' 377 member companies account for 91 percent of the life insurance industry's total assets, 90 percent of the life insurance premiums, and 95 percent of annuity considerations in the United States. Our members operating in international markets represent virtually all North American life insurance, life reinsurance, and retirement security providers with a global presence.

The Group of North American Insurance Enterprises (GNAIE) consists of Chief Financial Officers of leading insurance companies including life insurers, property and casualty insurers, and reinsurers. 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.

Over the last several weeks an issue which will result in significant accounting and reporting problems has surfaced. The issue is surrounding the applicability of the tests in paragraph 13 of FASB Statement No. 133 *Accounting for Derivative Instruments and Hedging Activities* (as amended and interpreted) ("SFAS 133") to risks of prepayability in beneficial interests in securitized financial assets. This issue necessitates additional direct guidance to prevent accounting and reporting problems in practice.

The beneficial interests and terms central to the issue previously have not been evaluated for embedded derivatives requiring bifurcation in reliance on the temporary exemption in

DIG Issue D1. The release in FASB Statement No. 155 *Accounting for Certain Hybrid Financial Instruments* ("SFAS 155") of final guidance surrounding the evaluation of beneficial interests in securitized financial assets and the repeal of the D1 exemption for transactions after the adoption of SFAS 155, has resulted in many preparers evaluating their positions in securitized financial assets for the first time (either at the time of their early adoption of SFAS 155 or currently in preparation for adoption of SFAS 155). As these evaluation activities have increased, varying interpretations surrounding SFAS 155 and its amendment of DIG Issue B-39, in particular, have arisen. The variability in the interpretations is significant and likely would result in just as significant differences in reporting for similar transactions among financial statement preparers.

The issue is the result of the modification to B-39 by SFAS 155 which was not included in the exposure draft for comment. Some of the more aggressive interpretations of this change were not anticipated by market participants including insurance companies, in particular. Our members had not anticipated the broad sweeping impact (which some interpretations now conclude) to the accounting for a significant portion of our investment portfolios upon the adoption of SFAS 155. Had there been an indication of such a broad impact and given the opportunity we would have had additional comments on the exposure draft. We would like to take the opportunity now to express our views.

Three primary points have been identified where additional specific guidance is being sought:

- Whether or not securitizing financial assets alters the principles in B-39 related to the lack of a unilateral investor ability to gain an economic benefit from the call?
- Whether or not the affect of subordination on prepayability should be afforded similar exemption from bifurcation, as the affect of subordination on credit?
- Whether or not the design of the paragraph 13(b) "double-double" test is appropriate to apply to debt hosted call options?

Principles Established Originally in B-39

DIG Issue B39 originally established that a debtor only ability to exercise a call option remained clearly and closely related to a debt host without further evaluation under paragraph 13(b) of SFAS 133, while maintaining the applicability of paragraph 61(d) for significant discounts, premiums and conditionality.

While typical beneficial interests in securitized financial assets have no actual terms that constitute a call option, some interpretations have been that the prepayability of the underlying pool of financial assets and its effect on the returns of the beneficial interests in that pool should be evaluated for possible bifurcation under SFAS 133 as embedded derivatives. The risk of prepayability being evaluated as implied terms under this interpretation are still call options which only the ultimate debtor holds. The implied terms still lack the unilateral investor ability to receive an economic benefit as a result of the option. We believe that inconsistent reporting of a directly held pool of financial

assets with debtor held call options as compared to a securitized interest in the same financial assets would be undesirable to financial statement users.

For terms and risks that are typical to debt instruments and clearly and closely related to investing in debt instruments we do not believe financial statement users will be provided with any additional relevant or meaningful information regarding prepayability. Relevant and meaningful information regarding prepayability and any effect of its subordination is already communicated to the financial statement user through the application of SFAS 91 and EITF Issue 99-20 to those estimated risks of prepayment. If testing of securitized prepayment risks under paragraph 13(b) is determined to be applicable and if testing determined that the underlying prepayment risk of the beneficial interest should be bifurcated as a derivative due to prepayment scenarios which are beyond remote (though contractually possible), financial statement users would lose relevant and meaningful information, as those prepayment risks, and the affect of their subordination, would no longer be reflected in the application of SFAS 91 or EITF 99-20 yield adjustments to the remaining host instrument once stripped of the implied call option.

Treatment of Subordinated Risks

The concentration of prepayment risk (both increased and decreased rates from original prepayment assumptions) through subordination have similar characteristics to concentrations of credit risk which were explicitly relieved of the paragraph 13(b) test. Similar to the basis for conclusions in paragraph A22, "the requirements of paragraph 13(b) of Statement 133 *for interest rate leverage factors*" should not be extended to concentrations of prepayment risk as a result of subordination in securitizations. There is no obligation on the part of the party with a concentration in prepayment risk to transfer cash or assets to the party with a decreased concentration in prepayment risk, nor does that party with the decreased concentration have a right to a transfer of cash or assets. The same cash flow mechanisms which result in credit concentrations are the cash flow mechanisms which result in prepayment concentrations.

Similarly the basis in paragraph A23 the conditions surrounding the recognition of fair value of a credit concentration in the purchase price and reported fair value of the instrument, also exist for concentrations of prepayment risk. Additionally, concentrations of prepayment risk are reflected in the income statement beyond their fair value through FAS 91 and EITF 99-20 yield adjustments.

We believe the same basis for the conclusion reached in the well researched credit concentration issue should be applied to prepayment concentrations which result from subordination.

Application of Paragraph 13 of SFAS 133

We believe that over time with additional guidance in the form of DIG Issues and firm interpretations, the types of embedded terms which the tests in paragraph 13 are being applied to goes beyond the original scope of only interest rate underlyings, including for

instance price underlyings similar to those in call options. As the original tests were designed for application to interest rate underlyings, rather than price underlyings, we believe that this broader application of the paragraph 13 tests over time has resulted in unintended consequences, requiring direct relief similar to what necessitated the original issuance of DIG B39.

The Board's original conclusion that prepayment and call options in debt instruments are clearly and closely related to the debt host has not been altered. However, we believe the initial design of the paragraph 13(b) test to capture structured aggressive interest rate underlyings, when applied to price underlyings not held by the investor (the returns of which are affected by possibly even insignificant discounts) is inappropriate and they should not be subjected to this test. The test was not designed for the evaluation of price underlyings and has proven inadequate for proper determination of whether or not subordinated prepayments are aggressive or not, as illustrated by the capturing of prepayment risks which are not aggressive, unless subjected to scenarios which are beyond remote.

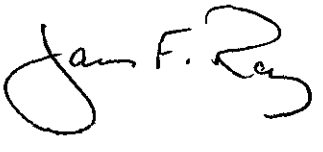
Conclusion

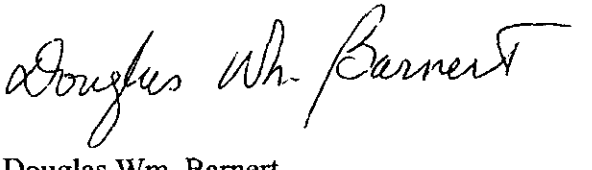
When the issues surrounding the 13(b) test are considered in combination with the decisions regarding the ultimate debtor's holding of the option (and lack of investor unilateral right to obtain gains from the option) and regarding the conclusion in FAS 155 not to bifurcate subordinated credit exposures, then we believe that the 13(b) tests likewise should not be applied to securitized asset prepayment exposures, whether or not those exposures have been subjected to securitized subordination.

We believe that the modification to B-39 without exposure and a basis for conclusion communicating its reasoning and intent has lead to potential conflicts with other existing guidance and confusion among both preparers and their advisors. We request the issues raised above be addressed by direct specific guidance on the issue of prepayability in securitized financial assets.

We have summarized our points above and would be pleased to discuss these or other points in more detail.

Sincerely,





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