



Moody's Investors Service

99 Church Street
New York, New York 10007

December 14, 2007

Technical Director- File Reference 1540-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116



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LETTER OF COMMENT NO.

Re: File Reference 1540-100 – FASB Agenda Proposal: Accounting for Insurance Contracts by Insurers and Policyholders, Including the IASB Discussion Paper, *Preliminary Views on Insurance Contracts*

Dear Sir or Madam:

We appreciate the opportunity to comment on the FASB's Agenda Proposal: Accounting for Insurance Contracts by Insurers and Policyholders, Including the IASB Discussion Paper, *Preliminary Views on Insurance Contracts*. We recognize the agenda proposal reflected by the invitation to comment (the "ITC") is intended to serve the needs of a broad audience of users, but the perspective we offer is that of credit analysts.

Moody's understands the underlying rationale for the IASB's proposed statement, which is to develop a *comprehensive international standard on accounting for insurance contracts*. Currently, many insurers around the world continue to report using the accounting policies determined by previous national accounting standards. Establishment of a common standard would result in enhanced comparability and transparency for users of financial statements.

We support the concept of alignment of international and U.S. reporting standards through the development of common, high-quality standards. In our role as a credit rating agency, Moody's uses financial statements in evaluating the creditworthiness and financial strength of insurers worldwide. Common financial statements would clearly improve comparability between international and U.S. insurance enterprises, bolstering our ability to perform analysis.

We would encourage the FASB to actively engage in the discussion with the IASB, to ensure a robust framework is in place to facilitate the implementation and adoption of such a radically different *accounting model*. We believe the Discussion Paper is a suitable starting point for the development of a comprehensive accounting model; we would, however, recommend that the FASB endeavor, in collaboration with the IASB, to undertake sufficient field-testing of the Discussion Paper's proposals prior to adoption. In particular, we would hope that such field-testing would indicate whether there may be a need for separate life and non-life insurance accounting models.

In general, the items we view favorably from the Invitation to Comment / Discussion Paper are as follows:

- Moody's strongly supports the FASB's participation in a joint project as a means to converge accounting standards. We believe it is critical that the FASB join the debate and work closely with the IASB in developing the proposed standard.
 - Although the FASB's participation in a joint project may delay implementation under IFRS, we consider convergence to be of much greater importance than meeting the projected 2011 implementation date.
 - A universal financial reporting framework would improve comparability between international and U.S. insurers, facilitating investor analysis. Such a universal framework would reduce the number of adjustments financial statement users must perform in assessing insurer financial statements.
 - Alignment of reporting standards will enhance the efficiency of capital markets and potentially lower insurers' cost of capital.
- Within Europe, diversity in accounting regimes has resulted in significant investor confusion. We've stated that convergence between US GAAP and IFRS would be beneficial; however, progress in developing insurance reporting standards for IFRS nations, beyond that of IFRS 4, is essential.
- Conceptually, Moody's supports the idea of more closely matching an insurer's financial statement presentation with the underlying economics of its business – an objective the current exit value ("CEV") framework is intended to achieve. Assuming robust disclosure and a more fully developed framework, CEV may potentially be a more useful indicator of insurance liabilities than that recorded under current standards, both in the U.S and internationally.
- Recording liabilities at current exit value may result in financial statements more closely aligned with the valuations of life insurance entities and closed block securitizations, as exhibited in the market.

Below are concerns we have regarding the initial conclusions of the IASB as indicated in the discussion paper:

- Increased subjectivity
 - The addition of discounting and risk/service margins to the calculation of insurance liabilities will add further complexity to the calculation of estimates, and this could make it more difficult for investors to determine the sufficiency of the reserves. Although current accounting standards do result in loss reserves that involve some subjectivity, the use of the CEV building blocks may convey a "false precision" of the recorded liability to users of the recorded liability. The CEV model requires complex valuation assessments of additional factors, which by their nature are difficult to determine and audit. As such, recording liabilities at CEV may or may not be more accurate than those recorded under current standards, despite giving investors and users the impression that more precision has been attained.

- The CEV approach, as determined by the building blocks described above, would result in additional financial statement volatility, with each subjective factor being subject to fluctuation and adjustment at the preparer's discretion. Volatility is not inherently objectionable to us, if it reflects true changes to the underlying economic nature of the liability; however, we are concerned that the subjective nature of the inputs may allow for profit smoothing and/or earnings manipulation.
- Although the use of current exit value is intended to yield a value for which an individual liability could be transferred to another party, there are few cases in practice where such a secondary market exists, limiting the reliability of that approach to valuing recorded liabilities. As such, the CEV concept will ultimately rely on "mark-to-model" methods, with all the credibility challenges typically associated with such approaches.
- Lack of specific structural framework
 - The IASB's proposal does not put forward a robust framework for the implementation of the CEV model. Without guidance on which to base decisions about reasonable assumptions to use in determining the building blocks of CEV, the proposal gives practitioners latitude in selecting the range of assumptions to be used, thereby raising the risk of earnings manipulation and making financial analysis more difficult.
 - The proposal indicates that the Board does not intend to develop detailed guidance on the determination of discount rates or risk margins. Without guidelines and rules for determining – and auditing – discount rates and margins, these components of current exit value could be very subjective and result in less useful financial statements.
 - The proposal does not describe in detail the disclosures that would be required under the CEV model. We believe that detailed disclosures, including the expected timing of cash flows, discount rates utilized, and determinants of risk and service margins, would be necessary to make financial statements useful to analysts.
- Profit at inception
 - The implementation method favored by the IASB does not prohibit profit recognition at inception. Although the concept of profit at inception would not be objectionable in situations where the underlying liabilities are determined with precision and some degree of certainty, the numerous assumptions which must be made to determine the CEV of a contract are by nature imprecise and variable. Profits recorded immediately upon the signing of a contract may not materialize. Given that the inputs into the CEV model are subjective, and may not result in a more reliable recorded liability, we are concerned that permitting profit at inception may result in intentional, or unintentional, earnings misstatements.
 - Given our focus as a rating agency on the ability of companies to cover their interest obligations with cash earnings, we are concerned that CEV-based earnings may lead to reported earnings showing sharp divergence from actual cash earnings generated that are available to pay interest in any given period.
 - Recognition of profit on Day 1 could potentially create incentive for insurers to write more business than is prudent, because of the immediate favorable effect on financial statements.

Thank you for considering our comments. We would be pleased to discuss any questions you may have at your convenience.

Sincerely,

Wallace Enman
VP – Senior Accounting Analyst