February 1, 2011

Technical Director
File Reference No. 1870-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Discussion Paper – Preliminary Views on Insurance Contracts

Ambac Financial Group, Inc. ("Ambac" or "the Company") appreciates the opportunity to comment on the FASB’s Discussion Paper, Preliminary Views on Insurance Contracts ("DP"). Ambac is a holding company whose affiliates provided financial guarantee insurance and financial services to clients in both the public and private sectors around the world.

We support the Board’s broad objective of improving and simplifying the financial reporting for insurance contracts, in principle. However, we have serious concerns about the DP’s impact on Ambac and the rest of the financial guarantee ("FG") industry in light of the enormous cost and effort of implementing two other accounting standards in the last two years that significantly changed the financial reporting model for FG contracts. More specifically, SFAS 163, Accounting for Financial Guarantee Insurance Contracts (ASC 944-20), was implemented beginning January 1, 2009, which was a comprehensive change to our revenue recognition and loss reserve model for FG contracts previously accounted for under SFAS 60, Accounting and Reporting by Insurance Enterprises. The FG project the FASB undertook leading up to the passage of SFAS 163 lasted approximately two years during which time there was extensive outreach by the FASB Staff to the investment analyst and financial statement user community, as well as to the industry itself, to develop an improved accounting standard. As such, given the recently deliberated FG insurance accounting model, we do not believe that making the significant changes proposed in the DP is necessary nor does it represent an improvement to the current model.

One year later SFAS 167, Amendments to FASB Interpretation No. 46(R) (ASU 2009-16), was implemented beginning January 1, 2010 which required consolidation of certain variable interest entities insured under FG contracts. SFAS 167 required significant resources to address interpretational issues unique to the FG industry and to analyze thousands of FG contracts to assess whether the consolidation tests in that standard were met. Furthermore, the FG contracts that were consolidated under SFAS 167 required the reversal of the insurance accounting effects of SFAS 163, which had just been implemented one year prior, which we believe has created confusion for users of our financial statements. Thus, the accounting treatment for a substantial subset of FG contracts changed twice within a one year time period, both of which required significant implementation and user education efforts.

The final question of the DP asks readers what they think would represent the most appropriate improvement to U.S. GAAP after considering the specific issues contained in the DP. Given the significant time and resources the Board, the FASB Staff, the FG industry and financial statement user community has spent deliberating and debating the substantial changes which have already greatly effected our industry’s accounting model over the last
two years, we strongly advocate making targeted changes to address specific concerns about current U.S. GAAP. Those targeted improvements are discussed herein:

Proposed improvements to the current financial guarantee insurance accounting model:

Consolidation of variable interest entities ("VIEs"):

Ambac has provided financial guarantees in respect of assets held or debt obligations of securitizations and other special purpose entities, including VIEs. Our primary variable interest exists through this financial guarantee insurance contract. As an insured VIE transaction's performance begins to deteriorate, Ambac establishes loss reserves under SFAS 163, which represent the probability-weighted estimate of cash outflows (i.e. claim payments). Upon the continued deterioration in the performance of an insured transaction or upon an event of default as specified in the legal documents, Ambac typically obtains certain loss remediation rights. In many cases, we have determined that these rights enable Ambac to direct the activities of the insured VIE that most significantly impacts the entity's economic performance. As a result, because Ambac also has the obligation to absorb the insured VIE's expected losses in transactions that have experienced performance deterioration that trigger such loss remediation rights, Ambac meets both parts of the "power and benefits" consolidation test under SFAS 167 and is therefore required to consolidate the insured VIE.

Thus, the recognition, measurement and characterization of our insurance exposure to a VIE on our financial statements is significantly different depending on the severity of the deterioration in an insured transaction. Said another way, the typical insurance accounting components users normally see on our financial statements includes premiums receivable, unearned premium revenue and loss reserves on the balance sheet and premiums earned and loss expenses on the income statement. At the point of obtaining certain loss remediation rights in an insured VIE, which may be caused by only slight performance deterioration, all insurance components are eliminated and the assets and liabilities of the VIE are consolidated, including those assets and liabilities which may not be insured by Ambac. This transition from an insurance accounting model to a consolidation model increases complexity, reduces transparency, decreases comparability across insurance contracts and lessens the relevance of financial reporting to users of our financial statements.

As a result, we strongly urge the Board to consider creating a scope exception under SFAS 167 for providers of financial guarantee contracts.

Gross measurement and recognition framework:

We agree with the broad concept of using probability-weighted estimates of cash flows to measure insurance contracts as discussed in the DP. However, we believe the measurement and recognition of probability-weighted cash flows should be on a gross basis, rather than on a net margin basis as proposed in the DP. We believe a gross measurement and recognition model more faithfully represents the economics of FG insurance contracts. In particular, we believe a gross approach would be more transparent to users of our financial statements in highlighting the two primary drivers of profit and loss which are: i) premium revenue (cash inflows) and ii) adverse development in our insurance book, specifically changes in loss reserves (claim payment cash outflows).
We believe the accounting principles already promulgated in SFAS 163 largely achieve most aspects of a transparent gross basis accounting model in that the premium and loss reserve components are all separately measured and recognized on the balance sheet (i.e. premium receivable, unearned premium revenue and claim liability) and the income statement (i.e. premium revenue and loss expenses). Furthermore, in the Background Information and Basis for Conclusions section of SFAS 163, the Board seemed to support a gross approach by acknowledging the existence of a premium receivable asset (cash inflows) that is separate and distinct from the claim liability (cash outflows).

Nonetheless we believe one particular aspect of the current financial guarantee gross measurement accounting model can be significantly improved. Under SFAS 163, loss reserves are not recognized until the present value of future claim payments exceed recorded unearned premium revenue ("UPR") based on the Board’s view that UPR and loss reserves represent the combined “stand-ready” obligation of a financial guarantor. Without debating the merits of this view, we believe this accounting treatment has had the unintended effects of delaying loss reserve recognition and decreasing the transparency of our financial statements. As a result, we would strongly encourage the Board to use this opportunity to reconsider de-linking these financial statement components when determining at what point loss reserves should be established under the current financial guarantee accounting guidance.

We appreciate the opportunity to provide comments on the DP and would welcome any future discussion with the FASB Staff regarding our concerns. Please contact Richard Alger (212-208-3196) with any questions or comments.

Sincerely,

Richard Alger
Managing Director
Accounting Policy