April 7, 2006

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Financial Accounting Standards Board

File Reference: 1250-001
Subject: The Fair Value Option for Financial Assets and Financial Liabilities

This letter is in response to the Invitation to Comment on the above-referenced matter.

By way of background I have been a security analyst following the insurance industry for over 30 years, so this letter can be classified as a user comment. While my comments address the fair value option overall, there also are specific observations that relate only to insurance contracts.

Conclusions

My conclusions are as follows:

- Fair value should be the standard for reporting financial assets and liabilities,
- Allowing a fair value option is a reasonable transitional step,
- Comparability among companies would be hurt by the fair value option, but that could be overcome with disclosure,
- Insurance contracts are financial liabilities and should be included in this statement,
- However, consistent with the logic employed for leases and employee benefits, the Board should consider postponing the inclusion of insurance contracts until the IASB has finished its work on Phase II.

Fair Value Accounting

I have long believed that financial assets and liabilities should be reported in the balance sheet at fair value. Since economic decisions are made based on current, not historic, values I believe financial statement users would benefit from having the same information that managements use in their decision process. The current mixed-attribute model evolved piecemeal as specific accounting standards were issued and does not reflect the way companies are run, nor is the model helpful to users.
An example of how the mixed attribute model is not helpful to users is the fact that analysts and portfolio managers convert insurance company book values to a "pre FAS 115 basis" for valuation purposes. Most investors recognize that requiring investments to be potentially adjusted to fair value creates an accounting inconsistency since the liabilities are not adjusted. As a consequence most analysts convert the book values of insurers to a pre FAS 115 basis, i.e. investments are converted back to historical cost to determine an adjusted book value, for analytical purposes. These adjustments would not be necessary if insurance contracts were reported at fair value.

In conclusion, I agree with the statement in the basis for conclusions that "the Board believes fair values for financial assets and financial liabilities provide more relevant and understandable information than cost or cost-based measures."

The Fair Value Option is a Reasonable Transition Step

As a believer in the usefulness of fair values I look forward to the time when these are required for all financial assets and liabilities. However, I recognize that there are practical considerations preventing this from happening in the near term. Therefore, I see the fair value option as a practical transition step.

Comparability Would be Hurt

There is little doubt that the comparability of companies would be hurt if some chose the fair value option for certain instruments while others did not. However, I believe financial statement users with adequate disclosure can overcome these inconsistencies.

I believe requiring disclosure of the assets and liabilities at fair value on the face of the statement of financial position is important to demonstrate the importance of the issue rather than requiring just footnote disclosure. Each of the presentation alternatives (separate line items or parenthetical disclosure) is acceptable and I have no preference between the two.

Regarding the income statement, disclosure of the gains or losses arising from the changes in fair value is critical to understanding the impact of fair value and it is equally important that these be disclosed on a by line basis so users can construct with-and-without income statements.

For the income statement items, footnote disclosure is acceptable.

Insurance Contracts as Financial Liabilities

Some outside observers (as well as a Board member as cited in paragraph A29) have noted that the inclusion of insurance contracts in the fair value option is inconsistent with FAS 107, which specifically excluded insurance contracts.
I have long believed that it was a wrong decision to exclude insurance contracts at that time and see no reason to continuing excluding them simply to be consistent.

In its basis for conclusions to FAS 107 the Board noted that "definitional and valuation difficulties are present to a certain extent in these contracts and obligations, and that further consideration is required ...."

I view the inclusion of insurance contracts in this Exposure Draft as being the result of that further consideration.

**But, Insurance Accounting is Being Reconsidered**

While I believe that the fair value option should be allowed for insurance contracts I also see their inclusion being inconsistent with the reasons for excluding leases and pensions and other postretirement benefits.

These are excluded because the Board believes “the accounting for such fair values for financial assets and financial liabilities should be part of a reconsideration of those areas and should not be affected by the fair value option.”

Using that logic, the Board might want to exclude insurance contracts until that time when the IASB finishes its work on Phase II and the FASB has incorporated the new requirements into its financial accounting standards.

Determining the fair values for insurance contracts is extremely complicated, as I am sure the IASB has discovered. Allowing insurers a fair value option without sufficient guidance on methodology would lead to considerable inconsistencies in application among companies and would likely require companies to restate to the new accounting standards when they are finalized. For those reasons, I believe insurance contracts should not be eligible for a fair value option.

I would be happy to discuss these comments further.

Sincerely,

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