April 11, 2006

Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Herz:

The American Council of Life Insurers (ACLI) would like to offer our comments on the FASB exposure draft that provides guidance for the fair value option election for certain financial assets and financial liabilities. The ACLI is the principal trade association of life insurance companies, representing 377 members that account for, in the aggregate, 91 percent of the assets of legal reserve life insurance companies in the United States.

After much debate, our membership was unable to come to a consensus position to support or oppose the option to fair value insurance contracts. The ACLI membership does support the option to fair value financial instruments as defined in Statement 107, which excludes insurance contracts. Based on current discussions with our membership we anticipate limited utilization of this guidance. Those companies that plan to use the option will do so to address current reporting issues such as those related to insurance liability hedging programs that do not qualify for hedge accounting under FAS 133, Accounting for Derivative Instruments and Hedging Activities, and the accounting for product guarantees within certain contracts offered by life insurance companies which are currently not recorded at fair value.

In the section below we will offer our comments relative to the specific issues for which the Board requested comments from recipients in the "Notice to Recipient" section of the exposure draft. In general, though, we believe that the FASB should escalate the priority of its project to improve the consistency and comparability of financial statement reporting, Financial Performance Reporting by Business Entities. We believe issuance of guidance that specifically addresses the issue of how to report changes in fair value of all financial instruments within the financial statements will help to ensure that the FASB's goals for this guidance of reducing complexity and ambiguity caused by the mixed attribute model will be achieved.

We also believe that the exposure draft in its current form does little to restrict or place limitations on the application of the fair value option. Without more clearly defined
limits and restrictions around the ability to apply fair value to certain financial assets and liabilities, we feel that this guidance has left the financial reporting community exposed to potential abuses of the optionality afforded in this exposure draft by companies who choose to apply fair value in an unrestricted manner. While adequate disclosure can mitigate this risk, many financial statement users rely on consistently presented income statement data to prepare comparability analytics between companies. It is not always feasible to mine through the footnotes to determine the disclosure adjustments necessary to arrive at consistently presented financial results.

We are also concerned with the practical considerations of applying the fair value option to issuer’s own creditworthiness, which we will discuss further in the next section.

**ACLI Response to Issues in Exposure Draft**

**Scope, Issue 1:** As stated above, our membership was unable to reach a consensus position on the use of the fair value option for insurance contracts.

**Scope, Issues 2 and 4:** These issues will not have a significant impact to the insurance industry, and as such, we do not have any comments regarding these issues at this time.

**Scope, Issue 3:** While the ACLI does not have a position on the exclusion of demand deposits from the Fair Value Option, we are aware that some may view cash surrender values as equivalent to demand deposits. We do not agree with that view. We are concerned that use of this option for life insurance contracts would result in their measurement at cash surrender value, which disregards the effect of policyholder behavior and future cash flows, and would not be an appropriate measure.

**Scope, Issue 5:** This issue seeks input on what nonfinancial assets and liabilities should be considered in Phase 2 of the fair value option project. We believe that the FASB should plan to initiate Phase 2 of this project subsequent to the completion and the initial adoption of the pending guidance in the *Fair Value Measurement* project. There will certainly be valuation questions regarding nonfinancial instruments and we believe that the industry would benefit by allowing fair value techniques to develop using the guidance provided by the FASB in the fair value project prior to considering a broader initiative that will enable a fair value option for all nonfinancial instruments. Therefore, we wish to defer our comments regarding the scope of Phase 2 of the fair value option project until we are able to apply the fair value methodology which will be detailed in the forthcoming guidance on fair value measurements to nonfinancial assets and liabilities which are significant to our member companies.

**Changes in Creditworthiness, Issue 6:** This issue seeks comments on the Board’s decision, in the exposure draft and in the Fair Value Measurements October 21, 2005 Working Draft, to include the change in issuer’s own creditworthiness as a component in the change in fair value of liabilities. Within the life insurance industry, if an entity were to fair value an insurance contract, questions have been raised as to whether the issuer’s own creditworthiness should be a component of that fair value. Many within the industry believe that issuer creditworthiness would not impact the fair value of insurance liabilities.
due to the regulatory nature of the life insurance industry. For example, state guaranty funds are in existence to provide for the satisfaction of insurance policyholder claims in the event of an issuer default. Because of these guaranty mechanisms, policyholders will not accept less than the amount stated in the insurance contract. Additionally, insurance liabilities are not typically adjusted for the impact of the issuer’s creditworthiness during the determination of fair value in the event of a sale of a block of policies or an entire insurance company; this further supports that the likelihood of insurance liabilities being settled for amounts less than the stated policy values is remote. An issuer’s creditworthiness will, however, impact lapse rates and policyholder behavior and may ultimately have an impact on the fair value determination. We believe that the impact of applying issuer’s own creditworthiness to the fair value calculation, for contracts issued by insurance companies, adds to the complexity of implementation of the accounting guidance, will reduce consistency of the application of fair value across companies, and adds very little value for financial statement users.

The question of whether to apply issuer’s own creditworthiness to debt liabilities also significantly impacts the life insurance industry given the amount of outstanding public and private debt held by our member companies and our role as financial statement users. We believe that applying changes in issuer’s own creditworthiness to the fair value of debt liabilities would lead to illogical financial statement results and would be misleading to financial statement users. Downgrades and other negative impacts to issuer creditworthiness would actually lead to contingent gains recognized on the income statement in one period with a series of small losses occurring over the remaining periods as the debt is accreted back to par, its ultimate settlement value. In fact, for the most part, the only scenarios in which an issuer’s debt will be settled for less than par are when that issuer is faced with an event that could drive it into or near to default of its obligation. This guidance, though, may actually serve to delay an inevitable covenant violation based on the strength of the company’s balance sheet and prevent it from having a qualifying default event due to the company’s election to mark its debt obligations to fair value. For example, consider the scenario in which an issuer is in danger of falling below its financial targets needed to meet its debt covenant and is in the process of restructuring. If the company applies the fair value option to its debt liability and recognizes a gain in the income statement and a reduction of its liability, it may be able to artificially avoid the trigger event that would necessitate a work-out. We believe that a company should only be able to reduce the value of its debt due to a decline in its creditworthiness if the company has secured an agreement with its counterparty to settle the debt for an amount less than its face amount. We strongly urge the FASB to reconsider including issuer’s own creditworthiness when assessing the application of the fair value option.

Presentation and Disclosure Requirements, Issue 7: The Board is seeking input in this issue regarding the geography of reported changes in fair value, the level of aggregation that is appropriate for those changes and additional disclosure requirements that should be considered.

Our comments are limited on this issue. We would only suggest that the Board require the fair value option disclosures to be included in one footnote. In fact, we would ask the Board to consider the disclosure requirements in IAS 39 as a starting point for disclosure under US GAAP. Due to our concerns with regard to the potential unrestricted
application of the fair value option and the users inability to easily locate the disclosures and ascertain when an entity has elected to use the fair value option, a requirement to aggregate the fair value disclosure information in one note would facilitate obtaining information that would improve the understanding of the financial statements while increasing the usability of the disclosures meant to augment the financial statements.

We also request that the FASB have the effective date of this standard follow the adoption of the Fair Value Measurements standard, which is effective for fiscal years beginning after November 15, 2007. The delay would also ease the implementation issues surrounding the fair value option. Even though it is an option, we believe the analysis required to determine whether or not to apply this option on existing assets and liabilities is complex and demands time and resources. In addition, there needs to be a period with which the accounting firms and the preparer community digest the guidance prior to becoming effective. The ability to have only one opportunity to elect the fair value option for existing assets and liabilities leads us to request the delayed effective date. Permission to early adopt should be offered so that those companies who are prepared to make the election may do so. Those companies who are dealing with the assessment of more complex financial instruments, such as insurance companies, may then be permitted additional time to continue to study the effects of adoption.

In summary, we would encourage the FASB to consider adding restrictions and eligibility criteria to the guidance as a premise underlying the ability to utilize the fair value option. We believe that this would provide further convergence with IAS 39 and would also help to ensure the responsible application of this standard across industries. We also believe that certain refinements, as we have discussed above, should be made to the exposure draft in order to improve its clarity and remove the potential for illogical financial statement results to emerge as a result of applying this standard. Finally, we encourage the FASB to further consider its broader agenda with concurrent projects such as Fair Value Measurements and Financial Performance Reporting by Business Entities as it finalizes this guidance. We believe that it is imperative that this guidance aligns with the FASB’s goals in these forthcoming projects in order to promote consistency and comparability of adoption within the preparer community. We also believe that the finalization of these projects will address issues such as the fair value measurement methodology and financial reporting framework that companies will need to employ in the future, which will be instrumental tools needed for companies’ to adopt standards such as this proposed standard.

Thank you for this opportunity to express our views, concerns, and recommendations on this developing accounting guidance. Should you have any questions or wish to discuss our concerns in greater detail, please feel free to contact us.

Sincerely,

James F. Renz
Director, Accounting Policy