April 14, 2006
Technical Director
File Reference 1250-001
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Technical Director:

We appreciate the opportunity to comment on the Exposure Draft, The Fair Value Option for Financial Assets and Financial Liabilities ("FVO ED"). Consistent with the FASB's commitment to support the convergence of US and International Accounting Standards ("IAS"), together with the existence of the FVO in International Accounting Standards No. 39, Financial Instruments: Recognition and Measurement ("IAS 39"), we were not surprised by the issuance of the FVO ED. We were, however, surprised that the FVO ED did not specifically exclude insurance contracts from its scope, similar to the exclusion that exists in IAS 39, as the accounting for insurance contracts is currently under reconsideration in the IASB/FASB Insurance Contracts Phase II Modified Joint Project ("MJP").

In our view, including insurance contracts within the scope of the FASB FVO ED is inconsistent with the existing scope exception in paragraph 8(c) of Statement of Financial Accounting Standards No. 107, Disclosures About Fair Values of Financial Instruments ("SFAS 107") which applies specifically to insurance contracts. In paragraph 74 of SFAS 107, the Board noted that disclosures about fair value should not be required for insurance contracts because, "definitional and valuation difficulties are present in those contracts and that further consideration would be required before decisions can be made about whether to apply the fair value definition to specific components of those contracts and whether to require disclosures about the fair value for the financial components" [emphasis added]. In our opinion, and as discussed further herein, the fundamental challenges and difficulties in determining the fair value of insurance contracts (which hereinafter is meant to include both life and property-casualty contracts) that existed at the time SFAS 107 was originally drafted, continue to persist in the current environment.

In addition to the inconsistency with existing US Accounting Standards, allowing the application of the FVO to insurance contracts is also inconsistent with existing IAS as well as the convergence of US and IAS, inasmuch as IAS 39 does not allow the application of its FVO to insurance contracts. We also believe allowing the FVO to be applied to insurance contracts would prematurely suggest that fair value is the appropriate measurement basis for insurance contracts, and further suggest that insurance contracts can be reliably fair valued, two issues that are in the midst of significant discussion in the MJP, and at this time remain unresolved. In addition, because the FVO ED allows selective application on a contract by contract basis, significant comparability issues would emerge both amongst, as well as within insurance companies.

In summary, we support continuing the MJP discussion process and adopting the accounting model for insurance contracts that emerges from that comprehensive debate. We also believe it would be preferable to have the effective date of the FASB's Fair Value
Measurement Standard ("FVMS") precede that of the FVO as we believe it essential to disseminate and allow reporting entities the opportunity to become accustomed to the new fair value measurement guidance before allowing the introduction of incremental fair value measurements in financial statements.

Notwithstanding the results of MJP, we do not believe it is currently possible to consistently or reliably "fair value" insurance contracts as no principal market exists for insurance contracts nor have any widely accepted fair value estimation methods been identified and tested. Accordingly, permitting reporting entities to selectively and subjectively estimate the fair value of insurance contracts in the absence of a principal (or reference) market would significantly impair the consistency, comparability, reliability and understandability of insurer's financial statements, and as such should not be allowed.

The remainder of this letter addresses certain specific questions identified in the FVO ED.

**Should an entity not be permitted the option to initially and subsequently measure those financial assets and financial liabilities or any others at fair value?**

We do not believe, at this time, given the fact both the FASB's FVMS as well as the IASB's MJP are incomplete, it would be appropriate to permit the measurement of insurance contracts at fair value. We believe that both of the aforementioned projects have a number of substantive unresolved issues that remain under consideration (e.g. how should "Level Three" fair value measurements, which would be the measurement category for insurance contracts, be recognized in financial statements; that is, directly in income or initially in other comprehensive income and later reclassified to income) and as such allowing reporting entities to apply the FVO to insurance contracts before those projects are complete would be premature. We believe the FASB should permit a scope exception for all insurance contracts in the FVO ED consistent with that in paragraph 8(c) of FAS 107. Thereafter, once the outcome of the MJP is known, the scope of the FVO could be modified, if necessary.

With respect to the fundamental issue of "fair valuing" insurance contracts, Allstate believes that in the absence of (a) an orderly transaction to sell or otherwise dispose of an asset or transfer a liability in the principal market for the asset or liability, or (b) market inputs that reflect the assumptions that market participants in the principal market would use in pricing the asset or liability (wording derived from the FVMS), reporting entities should not be allowed to subjectively develop "fair value proxies" and use those "proxies" to replace accounting measurements determined under existing accounting standards until such time as a new accounting model for insurance contracts is identified in the MJP. Moreover, given the absence of a liquid "principal market" for insurance contracts, we also believe any potential preliminary decision in MJP to allow a "mark to model" ("MTM" or "Level Three") approach to accounting for insurance contracts would need to be subjected to extensive field testing to determine whether allowing MTM accounting for insurance contracts can be accomplished in a manner that does not irreparably harm the consistency, comparability, reliability, and understandability of insurance company financial statements.

In connection with the preceding, we think it appropriate to address two issues that have frequently been raised in the ongoing debate about insurance contracts and whether they can be reliably fair valued. Those issues are (a) the existence of business combinations that might be used as "market indicators of the fair value of insurance contracts" and (b) the existence of reinsurance markets. In the case of business combinations, we have repeatedly heard that "insurance contracts can be fair valued and they are being fair valued all the time..."
in business combinations” which is required under SFAS No. 141, *Business Combinations* (SFAS 141). While we concur that there may be certain business combinations where the fair value of specific portfolios of insurance contracts are specifically negotiated in an arm’s length manner as part of the exchange transaction, those situations are atypical, as negotiations typically take place at a much higher level and do not involve price negotiations on specific underlying portfolios of insurance contracts. In any event, where arm’s-length negotiated values for insurance contracts do exist, we believe they should serve as the basis for insurance liabilities when allocating the purchase price in a business combination. At the same time, we believe it would be inappropriate to account for the aforementioned insurance contracts on Day 2 or thereafter at “fair value” as there would be no reference transaction or market from which to calibrate future periodic fair value changes.

In contrast to the preceding, in the more typical situation where the value of underlying portfolios of insurance contracts associated with a business combination are not separately negotiated, to comply with the requirements of SFAS 141 (which requires the purchase price to be allocated to the fair value of assets and liabilities acquired) we understand that acquirers generally engage in a wide variety of value estimation exercises and engage in consultations with outside valuation experts, public accountants, and sometimes regulatory authorities, in determining “a value” to assign to insurance contracts that serves as a proxy for “fair value”. In these situations, we believe the absence of any standard valuation methods and practices together with the inherent uniqueness of most insurance contracts (both amongst and within reporting entities) results in a significant degree of variation in the resulting “value estimates” that emerge as they relate to common classes of insurance contracts across the industry. Accordingly, we do not support the general supposition that “evidence supporting the presumption that insurance contracts can be fair valued is provided by the fact that recognizing the fair value of insurance contracts is currently required in connection with the allocation of purchase price for business combinations involving insurance companies” as there is generally no known degree of consistency in the estimation methodologies employed in the absence of specific negotiated values.

In the case of reinsurance, while we agree that reinsurance agreements that relate to specific portfolios of insurance contracts can provide an indication of the “fair value” of the subject insurance contracts, we do not believe the reinsurance market could ever be relied upon as a “principal market” as that term is used in the FVMS as there is a general lack of (a) standardization; which makes it difficult not only to compare transactions but also to apply indicators of value from one transaction to another, (b) transparency; because most transactions are private, the terms are not generally available to be relied upon as “market inputs” and (c) activity; there is generally not a sufficient amount of activity to provide “market value” indications on an on-going basis for any specific type of contract.

**Additional Insights on Insurance Contracts – Life versus Property-Casualty (“P&C”)**

We suspect that as it relates to the FVO and its potential application to insurance contracts, the FASB will likely receive limited support from a handful of life insurance companies and likely little, if any, support from P&C companies. We thought it would be useful to provide the Board with some insight as to the somewhat divergent views of life and P&C companies as we believe it may aid them as they further deliberate the FVO ED, the FVMS, and participate in discussions concerning the MJP.

First, it is essential to understand the fundamental structural differences that exist between life and P&C insurance contracts. More specifically, for P&C contracts, there is significantly
more uncertainty as to the timing and amount of loss payments, if any (i.e. whereas every person is certain to die, there is much less certainty that they will be involved in an auto accident in any given year, not to mention the inability to predict the severity of any potential loss if an accident occurs). Additional uncertainty exists between life and P&C contracts inasmuch as once losses are incurred, life related losses tend to settle relatively quickly whereas P&C claims, particularly certain long-tailed business, may be reported after very long periods and even then may have protracted negotiation and/or settlement periods (e.g. asbestos and environmental claims).

Consistent with the attributes of the underlying products, it is not surprising that in the life insurance industry there is a great deal of sophisticated asset-liability management ("ALM") practices that exist which frequently include the "proprietary modeling" of insurance liability cash flows and the matching of asset and liability cash flows to manage the business. In contrast, for P&C companies, ALM practices are much broader and more general than the practices employed by life insurers due to the inherent variability of liability cash flows which renders the exercise less meaningful for P&C companies (in contrast to their life counterparts).

It is our understanding that some life insurance actuaries believe their propriety modeling of insurance liability cash flows can be used as a reliable proxy for the "fair value" of insurance contracts (i.e. contracts that have significant insurance, mortality and/or morbidity risk). In contrast we are not aware of any P&C actuaries that regularly model P&C liability cash flows who believe the results of their modeling represents a reliable proxy for the "fair value" of their insurance contracts.

While we do not dispute the overall usefulness of information derived from proprietary ALM models of life insurance companies, which is generally used to aid in the management of the business, we do not believe the modeled output values of insurance contracts should be confused with "fair value" as that term is used in an authoritative accounting sense. More specifically, it is our understanding that these "non-standard" proprietary ALM models rely on inputs and assumptions that are, in many instances, internally and/or judgmentally determined. Accordingly, although we do not question the usefulness of ALM models for the purpose for which they were designed, we do not believe they should be allowed to be used as the basis for accounting measurements and financial reporting, unless and until, the models become standardized, specific guidance is developed as to how and where to derive model inputs, and the models are subjected to extensive field testing. Stated differently, we believe permitting insurance companies to selectively and subjectively estimate the fair value of insurance contracts on a contract by contract basis, in the absence of a principal (or reference) market using proprietary ALM models that rely, in part, on internally and/or judgmentally determined inputs, would significantly impair the consistency, comparability, reliability and understandability of insurer's financial statements, and as such should not be allowed.

Do you agree with the Board's decision [to record liabilities at fair value when the fair value option has been elected with all changes in fair value, including changes resulting from changes in the issuer's own creditworthiness, recorded in earnings]? If not, why? What alternative approaches or additional disclosure requirements should the board consider?

No. Although we understand the basic theoretical argument that supports consideration of "own credit standing" in measuring liabilities, we believe it would only distort the financial position of the reporting entity and would result in non-comparability of reporting entities.
Moreover, allowing for own creditworthiness is fundamentally inconsistent with the valuation of insurance liabilities in a going-concern framework. It should also be noted that in many jurisdictions, attempting to settle policyholder liabilities at a diminished value as the result of the deteriorating financial condition of the policy issuer would generally violate policyholder protection laws and could ultimately lead to the company being placed in receivership or liquidation. Similarly, outside a regulated insurance company, we do not believe it is reasonable to assume an entity whose financial condition is in a state of deterioration would have the financial wherewithal to “monetize” the impact of a credit downgrade by “buying back debt” (which is one of the few ways in which this theoretical value could be effectively monetized) as it presumptively would not have either excess cash or access to cash in the form of debt or equity (or at least not on terms that would make it economically advantageous to raise cash to settle outstanding debt at an amount lower than its carrying value). Accordingly, as it does not appear reasonably possible for a reporting entity to monetize the value of credit downgrades, we believe that reflecting them as a component of periodic income would be inappropriate and misleading.

We again thank you for the opportunity to comment on the FVO ED and should you have any questions or would like to meet to discuss the contents of the letter further, please contact me at (847) 402-2213.

Sincerely,

[Signature]

Samuel H. Pilch
Controller and Chief Accounting Officer
The Allstate Corporation