



LETTER OF COMMENT NO. 28

November 16, 2007

Mr. Russell G. Golden, Director
Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Via e-mail: director@fasb.org

File Reference No. 1540-100

Dear Mr. Golden,

Financial Security Assurance Holdings Ltd. ("FSA") is pleased to provide our comments on the Financial Accounting Standards Board's ("FASB" or "the Board") Invitation to Comment (the "ITC") on *Accounting for Insurance Contracts by Insurers and Policyholders, Including the IASB Discussion Paper, Preliminary Views on Insurance Contracts* (the "Preliminary Views"). FSA also participated in and supports the positions taken by the Association of Financial Guaranty Insurers ("AFGI") in AFGI's comment letter response.

Overview of the Company's Financial Guaranty Insurance Business:

FSA, through its insurance company subsidiaries, is primarily engaged in the business of providing financial guaranty insurance on municipal and asset-backed obligations in domestic and international markets. The financial strength of FSA's insurance company subsidiaries is rated "Triple-A" by the major securities rating agencies and obligations insured by them are awarded "Triple-A" ratings by reason of such insurance. FSA's principal insurance company subsidiary is a wholly-owned New York insurance company. Article 69 of the New York State Insurance Law ("Article 69") defines financial guaranty insurance, limits the lines of business of financial guaranty insurers to financial guaranty and related lines (surety, credit and residual value insurance) and sets single and aggregate risk limits, risk-based capital requirements and mandatory contingency reserves.

Financial guaranty insurance written by FSA typically guarantees scheduled payments on financial obligations, as permitted under Article 69. Upon a payment default on an insured obligation, FSA is generally required to pay the principal, interest or other amounts due in accordance with the obligation's original payment schedule or, at its election, may pay such amounts on an accelerated basis. FSA's underwriting policy is to insure obligations that would otherwise be investment grade without the benefit of FSA's insurance.

The Company's objective for its financial guaranty business is to remain a leading insurer of municipal and asset-backed obligations while generating premium volume at attractive returns and minimizing the occurrence and severity of credit losses in its insured portfolio. The Company's efforts to minimize the occurrence and severity of credit losses include not only stringent underwriting standards, but on-going surveillance of the insured portfolio.

The Company's Experience with IFRS Financial Statement Reporting:

At present, the Company and its operating subsidiaries maintain both U.S. GAAP and IFRS financial statements. By way of background, the Company was publicly held from 1994 until July 2000, with both

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common stock and debt listed on the New York Stock Exchange. On July 5, 2000, the Company completed a merger in which it became an indirect wholly owned¹ subsidiary of Dexia S.A. ("Dexia"), a Belgian corporation whose shares are traded on the Euronext Brussels and Euronext Paris markets as well as on the Luxembourg Stock Exchange. Dexia is primarily engaged in the business of public finance, banking and investment management in France, Belgium, Luxembourg and other European countries, as well as in the United States. The Company's debt continues to be listed on the New York Stock Exchange, and consequently the Company continues to file reports under the Exchange Act.

Dexia requires that the Company prepare periodic financial statements in accordance with IFRS for inclusion in Dexia's IFRS financial statements. The Company also uses IFRS for calculations of adjusted book value and operating earnings, for use in determining its annual bonus pool and valuing employee long term incentive compensation, in order to better align the interests of employees with the interests of its principal shareholder (Dexia).² Thus, the Company's accounting staff and external auditors utilize IFRS, both as a matter of necessity insofar as its parent company requires IFRS financial statements and to further the Company's identity as a member of the larger Dexia group of companies.

At the same time, the Company must, in connection with its listed debt issues, maintain financial statements in accordance with U.S. GAAP in order to satisfy its reporting obligations under the Exchange Act. In addition, the Company must prepare financial statements for its principal operating subsidiaries ("FSA") on a U.S. GAAP basis due to the application of Regulation S-X³ and Regulation AB⁴. FSA engages in the business of providing financial guaranty insurance on public finance and asset-backed securities ("ABS") in domestic and international markets. A significant portion of the insured securities consists of ABS publicly issued in the United States and governed by Regulation AB. Regulation AB, and amendments to Form 10-K and Form 10-D adopted in connection with Regulation AB, require that FSA provide U.S. GAAP financial statements meeting the requirements of Regulation S-X as part of the initial and ongoing financial information, respectively, to be provided to the ABS issuer.

General Observations:

Interdependence with Other Projects:

As we had stated in our comment letter on the proposed statement, "*Accounting for Financial Guarantee Insurance Contracts, an amendment of FASB Statement No. 60*", (the "FG Exposure Draft") the Company is supportive of the Board's intention to pursue this project in parallel with the IASB as we are concerned by significant non-parallel guidance changes. The Company agrees with the IASB's overall objective of establishing an accounting model for insurance contracts, as currently such a model does not exist in IFRS as it does for U.S. GAAP. We believe that the need for a comprehensive international insurance accounting model will become increasingly important in future years as the United States Securities and Exchange Commission ("SEC") advances along its "Roadmap to Convergence", which has so far led to permitting the filing of financial statements on an IFRS basis without providing a reconciliation to U.S. GAAP, and may ultimately lead to the adoption of IFRS as U.S. GAAP. Although that ultimate objective may be years away, we believe that it is still important for the FASB to participate in a joint undertaking with the IASB, however, we believe that it may be premature for the IASB to move ahead with such a project until such

¹ The Company is wholly owned by Dexia with the exception of shares owned by directors of the Company through the Company's Director Share Purchase Program. The number of shares issued to directors through this program is less than 1% of the Company's shares outstanding. Shares owned by directors are considered to be indirectly controlled by the Company.

² In 2004, the Company replaced its then existing incentive plan with a new plan which provides that book value measurements used in valuing performance share awards be determined in accordance with IFRS. Commencing in 2006, determinations of the annual bonus pool began to be made in accordance with IFRS rather than U.S. GAAP.

³ 17 CFR 210.1-01 through 210.12-29.

⁴ 17 CFR 229.1100 *et seq.*

other fundamental projects with regard to the common conceptual framework between U.S. GAAP and IFRS, fair value measurements, and revenue recognition, are completed.

Project Scope:

The Company agrees that it is a logical approach to agree on basic concepts first, including the project scope, as enumerated in the Preliminary Views, before embarking on an exposure draft. With regard to the project scope, it appears that the IASB intends the scope to be limited to “insurance contracts (including reinsurance contracts) issued by insurers and reinsurance contracts held by insurers”, whereas the FASB foresees that the project “has the potential to affect the accounting by both insurance entities and non-insurance entities that issue insurance contracts”. We believe that the scope suggested by the FASB, i.e., extending the scope to all insurance contracts regardless of the issuer, is a more comprehensive approach that will eliminate diversity in accounting treatment for the same product across industries, but we anticipate that both boards may face opposition to this approach from those outside the insurance industry.

Measurement of Insurance Liabilities:

Looking back on the FASB’s initiatives toward fair valuing assets and liabilities and the focus of the IASC’s⁵ initiatives with regard to insurance accounting, it is not surprising that the primary focus of the Preliminary Views is the measurement of insurance liabilities. The debate over whether to require insurance liabilities to be carried at fair value for U.S. GAAP and IFRS pre-dates the Preliminary Views, and therefore we will attempt to not repeat the arguments against fair valuing insurance liabilities that have already been asserted⁶. The Preliminary Views introduce some new twists on the old fair value debate, such as the adoption of the concept of “current exit value” that is borrowed from Statement No. 157, “*Fair Value Measurements*”, however the three building blocks that the current exit value would be based on, i.e., use of probability-weighted estimated cash flows, discounting liabilities to a present value, and imputing an estimated risk margin, are also not new concepts. Also borrowed from Statement No. 157 is the notion of considering an insurer’s “credit characteristics” in determination of the fair value of insurance liabilities. In addition to the artificial gains and losses that may be recognized on financial liabilities which the insurer cannot legally transfer to another party as a result of incorporating the insurer’s “credit characteristics” in the “exit price” of insurance liabilities, we also believe that imparting a credit characteristic to those liabilities implies a probably of default that contradicts the going concern assumption.

From the comment letters on the IASB’s discussion paper, “*Fair Value Measurements*”, we noted that one respondent remarked that Statement No. 157’s “market based” exit price definition of fair value is inappropriate in the many circumstances in which a “market” does not exist for a given asset or liability⁷. In the absence of a market for insurance liabilities, fair value is then based on hypothetical markets and market participants which are estimated by an entity’s management, as are current cost basis estimates. We similarly believe that determining an “exit price” for insurance liabilities that are “settled” rather than “sold” does not seem to provide useful or relevant information to users of our financial statements.

Also from an historical perspective, we note that insurance liabilities (other than financial guarantees and investment contracts) were excluded from the scope of financial assets and liabilities that were required to be disclosed under the guidance of Statement No. 107, “*Disclosures about Fair Value of Financial Instruments*”. We would believe that at the time of the writing of that standard that there was sufficient justification for exempting insurance liabilities from those disclosure requirements. We believe therefore that if the fair value of insurance liabilities was relevant to the users of our financial statements, users would

⁵ International Accounting Standards Committee (“IASC”), the predecessor to the IASB.

⁶ The Casualty Actuarial Society Task Force on Fair Value Liabilities’ “White Paper on Fair Valuing Property/Casualty Insurance Liabilities” (August 2000) was written to address fair value insurance issues raised by both the FASB and the IASC.

⁷ Comment letter submitted by Ian Mackintosh, Chairman, Accounting Standards Board (a part of the Financial Reporting Council), Aldwych, London, May 2, 2007.

have demanded at a minimum, that the fair value of insurance liabilities would be disclosed. In the roundtable discussion of the FG Exposure Draft hosted by the FASB on September 4, 2007, financial statement users and rating agencies remarked that fair value basis financial statement information was not useful or relevant as it incorporated factors unrelated to expected loss such as the effects of supply and demand on current pricing.

We also note that both the Fair Value Option amendment to IAS 39, "*Financial Instruments: Recognition and Measurement*" and Statement No. 159, "*Fair Value Option*", provides the irrevocable option to carry selected financial assets and liabilities at fair value. We believe that it is highly unlikely that any insurance entities will opt to fair value their insurance liabilities, not only because doing so would introduce unnecessary and irrelevant income statement volatility, but also for the same reasons that we are describing here. As we have seen from the assets and liabilities selected for fair valuing in the financial statements of those entities that early adopted Statement No. 157, the objective in those fair value elections was to eliminate the mismatch of assets/liabilities carried on a cost basis with related assets/liabilities carried on a fair value basis. Although our understanding is that the Board believes that fair valuing insurance liabilities will eliminate the mismatch between the insurance liabilities carried at estimated settlement cost and related invested assets carried at fair value under both IAS 39 and Statement No. 115, "*Accounting for Certain Investments in Debt and Equity*", the U.S. insurance industry does not believe that the mismatch diminishes the relevance or usefulness of the financial statements, nor does that industry believe that fair valuing the insurance liabilities is the solution to that mismatch.

As a financial guarantor, we believe that fair valuing insurance liabilities will create a financial reporting regimen that is similar to that of our insured credit default swaps ("CDS"). As we had discussed in our comment letter on the FG Exposure Draft, we believe that the economic similarities of financial guarantee insurance and credit derivatives are such that reporting the fair value through the income statement of credit derivatives is not useful and is in fact misleading. Changes in the fair value of credit derivatives with very strong credit quality typically arise from changes in credit spreads that incorporate risks other than the "failure to pay" risk that a financial guaranty insurer assumes in either a CDS contract or a financial guarantee contract. Accordingly, absent any claims under the guarantee, mark-to-market movements are expected to ultimately reverse when held to maturity (similar to how fair value related holding gains and losses on performing fixed income securities held to maturity ultimately reverse). Investors and creditors ignore the income statement effects of fair-valuing credit derivatives to assess our financial results because: (a) our insured CDS contracts are neither held for trading purposes, or used as hedging instruments, (b) financial guarantors are not entitled to terminate insured CDS and realize a profit on a position that is "in the money", nor is a counterparty to an insured CDS contract able to force a financial guarantor to terminate an insured CDS that is "out of the money", and (c) the liquidity risk present in most non-insured CDS contracts is not present in most insured CDS contracts, since the terms of the insured CDS contract are designed to replicate the payment provisions of financial guarantee contracts in that (i) losses, if any, are generally paid over time, and (ii) the insurer is not required to post collateral to secure its obligation under the insured CDS contract.

We believe the financial guarantor's loss recognition model appropriately reflects economic loss as incurred. Reporting changes in fair value of insured CDS contracts through the income statement has most recently produced large unrealized income statement losses, which will never be realized and have been a source of misleading accounting volatility. For sophisticated financial statement users, we have been able to explain the source of this volatility, but at added cost and with great effort. We are less certain that unsophisticated users understand the issues. Due to the extent of the unrealized losses on insured credit derivatives recently

experienced by financial guarantors, we have observed that both equity analysts and rating agencies have gone to great lengths to explain how this income statement volatility is not relevant and should be ignored⁸.

Conclusion:

Loss reserving models employed under U.S. GAAP reflect management's best estimate of an entity's obligation for future losses, therefore, we would not agree that substituting management's judgment with a hypothetical market estimate would provide financial statement users with a better estimate of that obligation than they already have. We believe that fair valuing insurance liabilities will only serve to introduce additional subjectivity to insurance liabilities and will consequently reduce their reliability to users of our financial statements and result in increased diversity in practice with regard to the determination of those liabilities. We suggest that there are many alternatives to fair valuing insurance liabilities, some of which were offered to both boards in previous fair value projects. If the boards decide that fair value is essential for insurance liabilities however, we suggest that the boards do not require the change in that fair value to be recorded in the income statement, but instead as a component of other comprehensive income as is permitted under both IFRS and U.S. GAAP for available for sale investments, as long as the insurance entity similarly demonstrates its intent and ability to "hold" the insurance contracts giving rise to the liability to their maturity (or settlement date). Although not part of the Preliminary Views, we believe that similar treatment of the change in fair value of insured credit derivatives would also result in a more meaningful financial statement presentation for the financial guarantee industry.

We would also be pleased to discuss our comments with you at your convenience. Please contact me at (212) 339-3483.

Sincerely,



Joseph W. Simon
Managing Director and Chief Financial Officer

⁸ Recent events in the capital markets have increased awareness of the financial guaranty insurance industry. To obtain a better understanding of the effect of these events on the Company and the industry, the Company suggests referring to its website at www.fsa.com and to recent rating agency publications.