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ASSOCIATION OF FINANCIAL GUARANTY INSURERS

Unconditional, Irrevocable Guaranty®

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



LETTER OF COMMENT NO.

29

File Reference No. 1540-100

Dear Mr. Golden,

This letter is submitted on behalf of the Association of Financial Guaranty Insurers ("AFGI" or "we") in response to 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. AFGI is the trade association of the insurers and reinsurers of municipal bonds and asset-backed securities. The members of AFGI are primarily engaged in the regulated business of financial guaranty ("FG") insurance. AFGI members provide credit enhancement for a wide variety of domestic and international transactions, with their business generally including public finance (municipal) and asset-backed security ("ABS") transactions. In a traditional FG transaction, the insurer guarantees scheduled payments on a bond or other debt security (also "the insured obligation") in exchange for payment of an insurance premium. Use of the guaranty generally attaches the insurer's credit rating (generally AAA) to the insured obligation, allowing the insured obligation to bear a lower interest rate than it would otherwise require.

Some of our members have either foreign ownership and/or operate foreign subsidiaries, both of which require those member firms to prepare financial statements on an accounting basis other than U.S. GAAP. We believe therefore that to the extent that our response incorporates the views of those member firms we are providing the Board with views that are not U.S. GAAP-centric, but rather U.S. GAAP – IFRS convergence minded.

We have provided comments to the FASB's questions in the attached **Appendix A**. We would also refer you to a separate letter we submitted to the IASB (**Appendix B**) on its Discussion Paper, *Preliminary Views on Insurance Contracts* ("IASB Paper"), concurrent with the submission of this letter, for our comments on the IASB's viewpoints.

We are available to discuss our comments and observations at your convenience.

Sincerely,

Sean Leonard

Chairman of the Financial Affairs Committee Association of Financial Guaranty Insurers

Appendix A:

The specific questions posed by the ITC and our responses follow:

Question 1: Is there a need for the FASB to comprehensively address accounting for insurance contracts? Why or why not?

Paragraph 32 of the ITC and Appendix C of the IASB Paper acknowledges a number of other fundamental projects that the FASB and the IASB (collectively "the boards") have added to their agendas, including the conceptual framework, revenue recognition and financial statement presentation. We agree with the FASB's sentiment in its ITC, that interdependence with those projects "could significantly affect the progress of an insurance contracts project". We cannot yet grasp the kinds of changes to financial statements that might ultimately result from those projects. Some of the principles under discussion in those projects would very significantly alter the context in which one would evaluate more specific proposals included in the Paper. Without understanding where the more fundamental projects are heading, we do not believe we, or other constituents, can appropriately consider and comment on the proposals specific to insurance contracts. That is, a parallel approach that requires constituents to comment before the nature of fundamental change is known risks impairing the effectiveness of the boards' due process. We believe therefore that the boards should defer further consideration of the specific project on accounting for insurance contracts until it is clearer what the ultimate outcome will be for the more fundamental projects. We also recommend that project documents, and related due process documents, include examples of insurance contracts and how they would be treated by proposed principles.

a. What aspects of existing U.S. GAAP accounting for insurance contracts could be improved or simplified and how pervasive are these issues?

In our view, there is no urgent need for a major overhaul of current U.S. GAAP insurance accounting, especially for short duration contracts. Current U.S. GAAP accounting approaches for those contracts are reasonably consistent and well understood. To the extent specific issues such as diversity in practice have been identified, the FASB has already undertaken several limited scope projects such as the accounting for financial guaranty contracts.

b. How important is the development of a common, high-quality standard used in both the U.S. and IFRS jurisdictions?

We believe that there will be an opportunity to simplify and improve accounting for insurance contracts in the context of a revised and improved basic financial reporting model that might emerge from the far reaching fundamental projects the boards have already undertaken should be used as a common standard for both U.S. GAAP and IFRS basis reporting.

Question 2: Are the preliminary views expressed in the IASB's Discussion Paper a suitable starting point for a project to improve, simplify, and converge U.S. financial reporting for insurance contracts? If not, why not?

- a. Do you believe the preliminary views would be feasible to implement? If not, what aspects of the preliminary views do you believe could be difficult to apply and why?
- b. Are there other alternatives to improve or simplify U.S. financial reporting for insurance contracts that you would recommend? What would be the benefits of those alternatives to users of financial statements?

We do not support the use of the IASB preliminary views as a starting point for a project at this time. We have doubts about both the cost and the usefulness of financial reports based on the current exit value measurement. Please refer to **Appendix B** for our further viewpoints on the IASB Paper.

Question 3: Is there a need to address accounting by policyholders in an insurance contracts project? Why? If yes, should accounting by policyholders be addressed at the same time as the accounting by insurers? Can or should that wait until after the accounting by insurers is completed?

We do not see any need for such a project at this time. As noted in our response to Question 1 above, we believe the boards should defer further consideration of the specific project on accounting for insurance contracts (from either an insurer or policyholder perspective) until it is clearer what the ultimate outcome will be for the more fundamental projects.

Question 4: How would you address the interaction between the accounting for insurance contracts and the FASB's other projects on the conceptual framework, revenue recognition, liabilities and equity, financial instruments, and financial statement presentation? Are certain projects precedential?

As noted in our letter to the IASB (Appendix B) we believe the fundamental projects on the agenda are very much precedential, such that it is not feasible for constituents to appropriately participate in due process (or perhaps for the boards and staff to appropriately address the issues) until more progress is made on those projects.

ASSOCIATION OF FINANCIAL GUARANTA INSURERS

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November 16, 2007

To The International Accounting Standards Board WWW.IASB.ORG

Re: Discussion Paper, Preliminary Views on Insurance Contracts

Ladies and Gentlemen:

This letter is submitted on behalf of the Association of Financial Guaranty Insurers ("AFGI" or "we") in response to the International Accounting Standards Board's ("IASB" or the "Board") Discussion Paper, Preliminary Views on Insurance Contracts, (the "Paper"). AFGI is the trade association of the insurers and reinsurers of municipal bonds and asset-backed securities. The members of AFGI are primarily engaged in the regulated business of financial guaranty ("FG") insurance. AFGI members provide credit enhancement for a wide variety of domestic and international transactions, with their business generally including public finance (municipal) and asset-backed security ("ABS") transactions. In a traditional FG transaction, the insurer guarantees scheduled payments on a bond or other debt security (also "the insured obligation") in exchange for payment of an insurance premium. Use of the guaranty generally attaches the insurer's credit rating (generally AAA) to the insured obligation, allowing the insured obligation to bear a lower interest rate than it would otherwise require.

Some of our members have either foreign ownership and/or operate foreign subsidiaries, both of which require those member firms to prepare financial statements on an accounting basis other than U.S. GAAP. We believe therefore that to the extent that our response incorporates the views of those member firms we are providing the Board with views that are not U.S. GAAP-centric, but rather U.S. GAAP – IFRS convergence minded.

General Observations:

Current Exit Value:

We strongly believe that "current exit value" is not the correct measurement attribute for insurance contracts. AFGI member firms provide credit protection in traditional insurance policy form and in credit default swap ("CDS") form. While the form of these credit enhancements may differ somewhat, the risk undertaken by the insurer and the substantive contractual provisions for both types of contract forms are identical. However, most CDS contracts do not meet the FG scope exclusion of paragraph 10(d) of Statement of Financial Accounting Standards No.133, Accounting for Derivative Instruments and Hedging Activities ("FAS 133"), primarily because the CDS contract does not require the beneficiary of the contract to be the direct legal owner of the insured obligation throughout the term of the protection provided. As a result, the CDS contracts are considered derivatives under FAS 133, with fair value changes recorded in earnings. The measurement attribute for CDS contracts in the United States is therefore similar to the IASB's definition of "current exit value" for insurance contracts.

AFGI believes it is uniquely qualified to comment on the usefulness of this measurement attribute based on past experience with users of our financial statements. Users have broadly indicated that they evaluate financial guarantees in the same manner, whether issued in CDS form or insurance form. In fact, because the terms of the financial guarantor's CDS contracts are almost identical to those of a traditional insurance policy, investors and analysts indicate that they generally ignore the income statement effects associated

with changes in credit spreads of CDS contracts since changes in fair value over the life of the CDS contract will ultimately sum to zero by the contract's maturity (absent any claim payments). As evidence of this assertion, we have compiled extracts of published reports submitted by equity and rating agency analysts who cover our industry (Attachment A). It seems fairly obvious that financial statement users would be more adamant in their view if all our FG contracts, including those issued in traditional insurance form, were required to be recorded at "current exit value". Also, since insurance contracts are not actively traded, the insurer's estimate of "current exit value" would be based on management's best estimate with few, if any, points of reference to observable markets. Finally, the cost of providing this information would far exceed the benefits derived, if any.

We believe a revenue recognition model based on the service provided to a policyholder is more appropriate than "current exit value" as proposed in the Paper. Under a FG contract, the beneficiary of a policy is protected for an economic loss throughout the term of the security. Accordingly, an insurer should recognize revenue as the protection (service) is provided. More specifically, we recommend a level yield approach based on the average principal balance of the insured obligation outstanding for the period. This method is consistent with the view of risk in the FG industry, which suggests that the marginal annual risk insured is nearly constant over the life of the transaction. We further believe that the recognition of a claim liability for a FG contract should be based on the present value of expected cash flows once an insurer identifies a deteriorating credit situation using internal "watch lists" or other surveillance methods. If the Board decides that fair value is essential for insurance liabilities however, we suggest that the Board require that changes in fair value be recorded as a component of other comprehensive income as is permitted under U.S. GAAP for available for-sale securities.

Impact of Other Fundamental Projects:

Appendix C of the Paper acknowledges a number of other fundamental projects that the IASB and the FASB (collectively "the boards") have added to their agendas, including the conceptual framework, revenue recognition and financial statement presentation. We agree with the FASB's sentiment in its concurrent Invitation to Comment, that interdependence with those projects "could significantly affect the progress of an insurance contracts project". We cannot yet grasp the kinds of changes to financial statements that might ultimately result from those projects. Some of the principles under discussion in those projects would very significantly alter the context in which one would evaluate more specific proposals included in the Paper. Without understanding where the more fundamental projects are heading, we do not believe we, or other constituents, can appropriately consider and comment on the proposals specific to insurance contracts. That is, a parallel approach that requires constituents to comment before the nature of fundamental change is known risks impairing the effectiveness of the boards' due process. We believe the boards should defer further consideration of the specific project on accounting for insurance contracts until it is clearer what the ultimate outcome will be for the more fundamental projects. It would be appropriate in working on those projects, and in related due process documents, to include examples of insurance contracts and how they would be treated by proposed principles. We believe that there will be an opportunity to simplify and improve accounting for insurance contracts in the context of a revised and improved basic financial reporting model that might emerge from the far reaching fundamental projects the boards have already undertaken.

If you have any questions regarding our responses, please contact Sean Leonard at (212) 208-3177.

Sincerely,

Sean Leonard

Chairman of the Financial Affairs Committee Association of Financial Guaranty Insurers

Attachment A

Equity Analyst Report Excerpts1:

User

Bank of America (October 11, 2007, Page 9-10)

Comment

FICTION: Mark to market losses on derivatives portfolios imply expected losses.

A negative mark to market does not imply that a payment or loss is imminent or even expected. Expected payments would be recorded as reserves and taken as losses. None of the bond insurers increased their reserves related to subprime exposure this quarter, reflecting the fact that its issues are performing well and none of its credit enhanced CDO tranches were downgraded or placed on negative watch in the second quarter. During their earnings calls, the bond insurers emphasized that they remain comfortable with their respective subprime portfolios and they have not seen the performance issues that have plagued the broader market. The bond insurers also noted that none of the RMBS or CDO tranches that they have wrapped have been downgraded or placed on negative watch by ratings agencies.

FACT: Mark to market of derivatives, but not traditional types of bond insurance, is required under SFAS 133. The decline in fair value of credit default swaps during the quarter was a function of declining yields and widening spreads seen in the broader market.

Insuring a transaction with a credit default swap is in essence exactly the same as traditional bond insurance; the difference is in the accounting. Credit default swaps must be marked to market under SFAS 133 while traditional bond insurance contracts do not qualify as derivatives and are thus not marked to fair value. In a rising yield and widening credit spread environment, the value of the derivatives will fall. As a result, with widening spreads, all of the bond insurers recorded mark-to-market losses on their derivatives portfolios in the first and second quarters of 2007. We would also expect third quarter mark to market losses to rise as CDO spreads continued to widen in July.

FACT: Bond insurers hold their credit default swap positions to maturity and mark to markets reverse over time.

As a writer of derivatives only for the purpose of providing insurance, the financial guarantors do not actively trade their portfolios, and they do not plan to sell its exposure to credit default swap positions before maturity. As a result, a mark to market on a credit derivative works in a similar fashion to the amortization of a discount on a bond. As time passes, and the potential cash flows required to be paid under the credit default swap decrease, fair value adjustments become smaller, ultimately reversing out.

^{1 -} Copies of the complete reports are available upon request

	As such, no losses will be realized on an unsold credit default swap without a credit event. As the bond insurers took no reserve charges related to subprime this quarter and expressed confidence about the quality of their subprime portfolios, that credit event does not appear likely at the current time.
Merrill Lynch (September 4, 2007, Page 5-6)	We consider credit derivative losses as unimportant, nonoperating items since, except in a rare case of a claim, offsetting gains will occur as maturity approaches. Because of the nature and amount of exposures that bond insurers are willing to guarantee in credit derivative form, we would expect any additional mark-to-market losses to be manageable as a percentage of book value and to be unlikely to cause rating agency analysts any major concerns. Also, note that these marks for bond insurers have no collateral posting implications. However, we would be concerned about mark-to-market losses on credit derivative exposures if a single transaction experienced a particularly large mark. In our view, such a circumstance would indicate an increased likelihood of an actual claim on that transaction.
	Contracts for guarantees performed in credit-derivative form (the typical execution on CDOs) do not require the bond insurer to post collateral based on market value declines, regardless of the size of the mark-to-market adjustment and regardless of the insurer's own rating. Such a situation distinguishes bond insurers from other CDS market participants. Also, despite the credit derivative form of the guarantees, the financial guarantor would be required to pay any claims only on a "pay as you go" basis (i.e., in keeping with scheduled principal and interest payments and not on any accelerated basis). This is favorable for the liquidity risk profile of bond insurers.
Calyon Securities (August 10, 2007, Page 1)	The company's business written through credit default swaps unfortunately must comply with FAS 133, which requires that derivatives are marked-to-market. The mark this quarter amounted to \$12.7 million or \$0.18 per share. We do not believe that this is the best accounting treatment for companies that do not trade these positions. The mark in all likelihood will amortize to zero at contract maturity, if not sooner.
KBW (October 11, 2007, Page 6)	As we do not believe that the FAS 133 marks are fundamentally relevant, we do not forecast them in our models and we completely strip these marks, whether positive or negative, out of our assessment of each company's operating results. Our review of the mark above is simply an attempt to prepare the market for amplified "noise" in the numbers this quarter.
FPK (October 11, 2007, Page 2)	We reiterate however, that these are just accounting marks and do not reflect cash or economic losses. Unless these are real losses, these marks will revert to zero over time.
William Blair & Company (October 11, 2007, Page 6)	The company expects to record a \$743 million mark-to-market loss on its credit derivatives portfolio (FAS No. 133 adjustments for financial guarantee transaction executed in derivative form), given much wider credit spreads within structured finance (mortgage and corporate related), and therefore expects to report up to a \$3.50 per share loss on a GAAP basis. While the loss is higher than we expected, there seems to be a massive misunderstanding of the importance of this measure, as this mark-to-market loss is only an accounting adjustment, it has no economic impact on the company's business, it does not affect capital adequacy, it creates no liquidity risk, and should reverse over time. In fact, we believe FAS No. 133 is actually a very bad rule for the accounting of financial guaranty contracts executed in derivative form.

Rating Agency Report Excerpts²:

User	Comment
Fitch Ratings (October 11, 2007, Page 2)	Furthermore, the financial guarantors insure these transactions until maturity (akin to a traditional financial guaranty policy), and are responsible for the payment of any missed principal and interest payments due over the life of a transaction. Over time the unrealized gains and losses on performing CDS transactions are expected to net back to zero as they reach maturity. Therefore, from a financial and capital modeling perspective, Fitch treats financial guarantors' issued CDS and traditional financial guaranty policies alike.
Standard & Poor's (Ratings Direct - October 31, 2007, Page 3-5)	Mark-to-market accounting for credit derivatives introduces inconsistent treatment within insurers' financial statements (relative to the similar risk encompassed in a traditional guarantee arrangement) based solely on the form of the risk assumption and not on the substance of risk assumed. Moreover, it substitutes market judgment for management's judgment in setting loss reserves and results in income statement volatility that may have little to do with the actual risk of loss. For these reasons, while Standard & Poor's assesses the marks for actual credit deterioration, in the absence of it we do not ascribe any analytical significance to these negative marks as relating to our assessments of capital adequacy or profitability. We discuss each of these reasons below in more detail: The S&P paper goes on to describe 3 reasons in further detail: 1) Not predictive of loss, 2) No liquidity risk and 3) Swap not cancelable Standard & Poor's strongly prefers the accounting model used on financial guarantee policies where the counterparties post reserves when the possibility of loss has become significant. Posting reserves when the possibility of losses remains remote, which is what essentially occurs with derivative contract accounting for bond insurers, tends to obscure the actual potential for losses.

² - Copies of the complete reports are available upon request