AMERICAN ACADEMY *of* ACTUARIES

November 9, 2005

Technical Director – File Reference 1204-001
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, Connecticut 06856-5116

Letter of Comment No: 239
File Reference: 1204-001

RE: Proposed Statement of Financial Accounting Standards, *Business Combinations, a replacement of FASB Statement No. 141*

Dear Sir/Madam,

The Life Financial Reporting Committee of the American Academy of Actuaries has prepared the following comments on the Proposed Statement of Financial Accounting Standards, *Business Combinations*, (the "Proposed FASB Statement"). Our review and comments are limited to the technical issue of valuation of insurance contracts for the life insurance industry both at and following acquisition. We believe that the Proposed FASB Statement would represent an improvement to accounting practices and increase consistency of presentation across companies.

In particular, we feel the example given in paragraph A49d appropriately addresses an important issue regarding the fair value at acquisition of a portfolio of insurance contracts. Specifically, it clarifies that this fair value is reported in accordance with FAS 60 by expanding the presentation into a liability component and an intangible asset for value of business acquired (VOBA) component. We believe this is the appropriate and logical approach and conforms to how many insurance company transactions have been accounted for in practice.

Our additional comments are as follows:

1. Paragraph 36.b.(2) addresses the above issue of separately reporting the liability and VOBA components for insurance contracts. We suggest amending Paragraph 36.b.(2) as follows (where additions are underlined): "A contingency that is an asset or liability arising from an insurance contract shall be accounted for in accordance with the FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* as amended (including the intangible asset <u>or liability</u>, if any, recognized for the difference between the amounts recognized on the acquisition date at fair value and the amounts that would be recognized in accordance with Statements 60.)"

   It is possible that the difference between the fair value and the FAS 60 liability at acquisition date is negative. For example this could occur for a universal life-type contract where FAS 60 (as amended by FAS 97) sets the liability equal to the contractholders' account values and where this amount is less than the fair value. We do not feel it would be appropriate to immediately release this difference into income.

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2. Paragraphs 59 through 61 address the issue of potential negative goodwill. Paragraph 59 notes this situation can arise because of a bargain purchase or because certain items are held at prescribed values different than fair value. Paragraph 60 then requires a remeasurement assessment and paragraph 61 requires any remaining negative goodwill be released into income. It is not clear to us from the wording of paragraphs 60 and 61 whether or not one is required to remeasure to fair value those items otherwise held at "book" value.

   This issue could be significant for certain insurance contract acquisitions. For example, consider acquisition at a market price of a block of structured settlement contracts with a deferred tax asset arising from the transaction of $100 million on a book basis and $40 million on a fair value basis (not at all an unrealistic example based on fair value discounting for tax reversals over very long durations). Our question is whether the acquirer (1) holds $100 million deferred tax asset, sets goodwill to zero and reports $60 million income even though there is no bargain purchase, or (2) holds $100 million deferred tax asset and holds negative goodwill of $60 million (to extent goodwill is zero on a fair value basis), or (3) holds $40 million deferred tax asset and goodwill of zero?

3. Paragraph D13 clarifies that VOBA is to be explicitly included in FAS 60 when performing premium deficiency testing. Specifically, paragraph D13 amends paragraph 33 of FAS 60 in respect of short duration contracts as follows: "A premium deficiency shall be recognized if the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs, <u>intangible assets recognized for acquired contracts</u>, and maintenance costs exceeds related unearned premiums."

   We feel it is appropriate to have consistent treatment with respect to long duration contracts by amending paragraph 35 of FAS 60 as follows: "…Less the liability for future policy benefits at the valuation date, reduced by unamortized acquisition costs <u>and intangible assets recognized for acquired contracts</u>."

We thank you for the opportunity to comment and would be happy to respond to any inquiries.

Sincerely

/S:/
Errol Cramer
Chair, Life Financial Reporting Committee
American Academy of Actuaries