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Via E-mail: ***director@fasb.org,***
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Financial Accounting Standards Board
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Letter of Comment No: 200
File Reference: EITF03-1A

Re: *Comments on Proposed FSP EITF 03-1-a*

The American Insurance Association ("AIA") is a leading property – casualty insurance trade organization, representing approximately 415 insurers that write more than $114 billion in premiums each year and offer all types of property - casualty insurance. On behalf of the members of AIA, we are submitting these comments regarding implementation guidance for the application of paragraph 16 of EITF Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments".

Summary of Concerns

According to the Insurance Information Institute, approximately two-thirds of the invested assets of the property-casualty insurance industry are carried as high quality bonds, such as federal treasury securities. Our members generally classify these investments as available-for-sale ("AFS") securities. Consequently, our members have a legitimate interest in seeing that the Financial Accounting Standards Board ("FASB") implement appropriate accounting guidance for AFS debt securities. We believe, however, that the guidance in paragraph 16 of the EITF 03-1 Abstract will lead to a misapplication of the guidance in Statement of Financial Accounting Standard No. 115 ("SFAS No. 115") and could result in unnecessary impairment charges to debt securities for which there may be no impairment factor other than a change in the interest rate environment.

With respect to AFS debt securities, we disagree with the EITF guidance that an impairment should be deemed as other-than-temporary if the investor does not have the ability or intent to hold the investment until sufficient fair value has been recovered to recoup the cost, which could include the maturity date. The AFS guidance under SFAS No. 115 provides for an adjustment to fair value and the recording of the resulting unrealized gains and losses in Other Comprehensive Income. We believe this approach remains useful to financial statement users.

Under the EITF 03-1 guidance -- and its additional requirement that the investor have the ability and intent to hold an investment until a forecasted recovery of fair value up to (or beyond) the cost of the investment -- we are concerned AFS debt securities portfolios will be unnecessarily subjected to impairment charges when an investor sells an AFS security for reasons that are otherwise acceptable under SFAS No. 115 (such as liquidity needs).

Further, the EITF guidance will lead to a distortion of financial results and therefore compromise the usefulness of financial statements. Again, our concern focuses on high quality debt securities, for which there is little risk of not receiving the contractual cash flows (principal and interest). As the impaired securities mature, it will be necessary to accrete the impairment charges back into income in order to increase the carrying value of the debt securities to their maturity value. The obvious question is how does a charge in one period (the impairment) and restoration of that charge in later periods (effective yield accretion) provide more useful information to financial statement users – especially in situations where there has been no change, other than interest rates, in the applicable legal or economic environments of the issuer?

Even though SFAS 115 declined to provide comprehensive guidance on applying other-than-temporary criteria, the FASB acknowledged, in paragraph 114, its belief that other-than-temporary impairment exists if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the security. For paragraph 16 purposes, which specifically applies to debt securities that cannot be contractually prepaid or otherwise settled in a way that would not recover all of the investment costs, we believe the only appropriate determination to be made should be whether it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the debt securities. Accordingly, the Board should reconsider its ratification of EITF 03-1 and in doing so, consider deleting part (a) of paragraph 16, regarding ability and intent to hold, and the last sentence of paragraph 16, with its controversial "pattern of selling" language. Doing so will go a long way toward eliminating the confusion and uncertainty introduced by the EITF 03-1 guidance with respect to AFS debt securities.

We now turn to the questions raised in the proposed FSP.

Specific Board Issues

Minor Impairments

Do you believe that financial statement preparers and auditors will be able to apply the notion of "minor impairment" without any additional guidance from the FASB? If not, do you believe that the Board should specify a numerical rule or threshold and, if so, what would that rule or threshold be?

AIA Comments: we believe focusing on whether an impairment is or is not "minor" distracts from the more relevant inquiry of what is causing the impairment. Debt securities are issued and traded within a dynamic investment market – meaning interest rates will always be changing and therefore the fair value of those securities will change. It should be accepted as axiomatic that some impairment will result when interest rates rise. It also follows that changes in interest rates may, over the longer term, recover any impairment.

It may be helpful for the FASB to provide general guidance on how a holder might go about determining minor impairments, laying out factors such as type of security, severity and duration of impairment as considerations. Ultimately, however, we believe the holders are in the best position for determining "minor" within the context of their individual risk management practices.

Any specific guidance from the FASB ought to focus on distinguishing between impairments arising from increases in interest rates or sector spreads on one hand and operational or economic changes affecting the issuer on the other. A "bright-line" threshold does nothing to address the difficult, yet more meaningful, task of identifying the causes of impairments.

Limiting the Notion of Minor Impairments to Debt Securities Evaluated for Impairment Pursuant to Paragraph 16 of Issue 03-1

Do you support the Board's conclusion to limit the notion of "minor impairments" to debt securities analyzed for impairment under paragraph 16 that are impaired because of interest rate and/or sector spread increases? If not, why?

AIA Comments: The mere suggestion of limiting the notion of minor impairment to debt securities invites further inquiry as to whether other securities may suffer minor impairments because of interest rate and/or sector spread increases. An overall review of EITF 03-1 is probably warranted and from that perspective, a more thorough review of this notion would be advisable. As stated above, however, we do not believe that developing guidance specifically for the determination of "minor impairments" is helpful. It is probably more useful – to preparers, auditors and users – to provide guidance to help identify the impairment resulting from interest rate and/or sector spread increases, versus impairments arising for other reasons.

Proposed FSP 03-1-a

Question 1: At what unit of account should an investor assert its ability and intent to hold to a forecasted recovery?

FASB Staff Response. An investor should assert its ability and intent to hold to a forecasted recovery at the individual security level, as stated in paragraph 16 of Statement 115.

AIA Comments: Staff's response raises both a conceptual and practical concern. If the assertion is made at the individual security level, it should follow that an other-than-temporary determination should also be at the individual security level. The last sentence in paragraph 16 of EITF 03-1 states: *"Although not presumptive, a pattern of selling investments prior to the forecasted recovery of fair value may call into question the investor's intent."* If an other-than-temporary determination is done on a security-by-security basis, it is not clear why the other-than-temporary determination of one security should call into question the intent to hold other securities. The particular factors leading to the other-than-temporary determination of an individual security may not be relevant to other securities. As a practical matter, this "tainting" language of paragraph 16 may be used as a basis for impairing entire portfolios, regardless of the specific factors that may have justified the decision to write-down or sell a particular security.

Question 2: Although Issue 03-1 states that an investment is impaired if the fair value of the investment is less than its cost, paragraph 16 does not refer to the severity of the impairment. Is there a level of impairment that can be considered temporary that would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery?

FASB Staff Response. Paragraph 16 of Issue 03-1 is designed, in part, to acknowledge that impairments caused solely by changes in interest rates and/or sector spreads will be recovered, absent a sale prior to recovery or maturity. However, paragraph 16 does not discuss the severity of impairments caused by interest rates and/or sector spreads. For purposes of applying paragraph 16, a minor impairment caused by interest rate and/or sector spread increases can be considered temporary and would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery.

AIA Comments: We agree with the Staff that a minor impairment caused by interest rate and/or sector spread increases can be considered temporary and would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery. The source of the impairment and the duration of the impairment are also important factors and should also be considered in determining whether the impairment is other-than-temporary. We do not believe, however, that a "bright line" test should be applied in determining an acceptable level of impairment that would not require an assertion. That determination should be made on the basis of the specific facts and circumstances.

Question 3(a): If an interest-rate-impaired and/or sector-spread-impaired security for which the investor previously had asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, when is the impairment considered other than temporary?

FASB Staff Response. An impairment is considered other than temporary when the investor's assertion to hold an investment to a forecasted recovery changes. EITF Topic No. D-44, "Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value," and question 47 of FASB Special Report, *A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities,* provide guidance in this area. Under that guidance, an investor should recognize an impairment when it has decided to sell an impaired security. However, that guidance should ***not*** be interpreted to mean that an investor should wait to recognize an other-than-temporary impairment until it has decided to sell an impaired security.

AIA Comments: we believe that the guidance of Topic D-44 should apply, i.e., the security should be impaired only when the decision to sell has been made. It would be difficult to implement based upon when a company changes its assertion versus when a decision to sell has been made. A company could change its assertion but then never sell the security.

Question 3(b): If an interest-rate-impaired and/or sector-spread-impaired security for which the investor previously had asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, are there circumstances for such a change in ability or intent that would not necessarily call into question the investor's ability or intent to hold other securities to recovery?

FASB Staff Response. There are circumstances for such a change in ability or intent that would not necessarily call into question the investor's ability or intent to hold other securities to recovery, including those changes in circumstances that do not call into question the investor held-to-maturity classification, discussed in paragraphs 8 and 11 of Statement 115. For debt securities that are impaired because of interest rate and/or sector spread increases and that are analyzed for impairment under paragraph 16 of Issue 03-1, the following circumstances also would not necessarily call into question the investor's ability or intent to hold other securities to recovery:

a. Unexpected and significant changes in liquidity needs,
b. Unexpected and significant increases in interest rates and/or sector spreads that significantly extend the period that a security would need to be held by the investor, and
c. A de minimis volume of sales of securities.

An analysis of the investor's ability and intent to hold other securities to recovery is required only for those securities for which the investor previously had asserted its ability and intent to hold to recovery. Sales of available-for-sale securities for which the investor does not assert its ability and intent to hold to recovery do not call into question the investor's ability and intent to hold other securities for which the investor has asserted its ability and intent to hold to recovery. However, impairments on securities for which the investor has not asserted its ability and intent to hold to recovery should be recognized currently in earnings.

AIA Comments: We agree with the Staff's analysis as it relates to held-to-maturity securities. What is confusing is the application of the EITF 03-1 guidance to AFS debt securities – we believe it is inconsistent with SFAS 115 guidance and we urge the Board to use this opportunity to clarify the application of SFAS 115 and EITF 03-1 to AFS debt securities.

Other Considerations

In closing, we would like to add that there are other issues that the EITF 03-1 creates.

Recycling of Income. The subsequent accretion of impairment charges undermines the usefulness of the income statement. It could also distort key financial measures that financial analysts and rating agencies require. It also complicates SEC disclosure obligations with respect to non-GAAP measurements.

Portfolio management. Companies' investment policies and practices are designed to achieve their specific objectives with respect to managing risk, maximizing return, and providing liquidity. Compliance with the EITF guidance may necessitate a rebalancing of their securities portfolios.

Record-keeping. Some of our members may need to commit significant resources to make the necessary system modifications in order to account for the multiple cost bases that the interest rate impairments will create and the related amortization. In addition, these modifications would need to be extensively tested for compliance with companies' obligations under Sarbanes-Oxley.

Given the concerns raised in this letter, we again urge the Board to undertake a thorough review of EITF 03-1, provide guidance on its application to SFAS No. 115, and if necessary, reconsider its ratification of the EITF guidance. We appreciate this opportunity to provide comments, and welcome any questions you may have.

Sincerely,

Phillip L. Carson

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