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Mr. Larry Smith Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

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Letter of Comment No: File Reference: FSPTB85-4-A **DAte Received:**

FSP TB 85-4-a

Dear Mr. Smith:

The purpose of this letter is to submit comments from management of CNA Financial Corporation (CNAF) regarding the proposed FASB Staff Position No. TB 85-4-a, Accounting for Life Settlement Contracts by Investors. (FSP 85-4). We appreciate the opportunity to provide input regarding the proposed standard. Our comments focus on certain aspects of the life insurance business which, in our opinion, the standard fails to capture and the need for a mechanism to periodically test for recoverability of the carrying value of the asset. We have proposed an alternative for your consideration.

Business Background

Viaticus, Inc. (Viaticus), a wholly-owned subsidiary of CNA Financial Corporation, was in the business of purchasing life insurance policies directly from policy owners, where the insured's health had deteriorated subsequent to the time of the policy owner's initial purchase of the life insurance policy from the life insurer. Policies owned by Viaticus are predominantly universal life policies, renewable term life policies and whole life policies.

Once purchased, Viaticus became both the owner and beneficiary of the life insurance policy. As such, Viaticus is required to pay all the future premiums necessary to keep the policy in force. For whole life and term policies, the scheduled premiums are paid. For universal life policies, the minimum premiums to keep the policy in force are paid. Upon death of the insured, Viaticus files the death claim with the insurance company and collects the death benefit.

Concerns with the Proposed FSP:

The FSP proposes the use of the cost accumulation model (Investment Method) to determine the carrying value for life insurance policies owned by life settlement providers. Under the Investment Method, the initial cash outlays to purchase the policy along with continuing premiums are capitalized up to the face amount of the policy, until such time that either the insured dies, the policy endows or the policy lapses.

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While the investment method is straightforward, which simplifies the accounting for life settlement contracts and allows for ease of maintenance and auditable asset values, it has some significant deficiencies that merit comment -

- As outlined in Paragraph 5 of FTB 85-4, a portion of the premium pays the insurer for assumption of
 mortality risk and provides for recovery of the insurer's contract acquisition, initiation and maintenance costs.
 Another portion of the premium contributes to the accumulation of contract values or cash surrender values.
 The Investment Method being proposed by FSP No. TB 85-a calls for capitalizing premiums as continuing
 costs of the policy. By capitalizing the portion of the premium that represents a mortality charge, costs would
 be deferred that are not recoverable in future periods and have no benefit beyond the modal period to which
 the premium pertains. The mortality charge is a period cost since there is no future benefit to be received
 beyond the modal period, except that paying the premium keeps the policy in-force. This benefit expires by
 the time the next premium is due and is only of a temporary nature.
- There is a need for a mechanism to assess and measure impairment of the carrying value of the asset where there has been a significant change in the underlying economics of the policy from the original purchase assumptions or when the carrying value of the policy nears the face amount.
 - A significant increase in longevity can occur due to medical advancements or the lack of industry experience in rating moderate to highly substandard risks. This increase in longevity would result in a greater likelihood that the provider may lapse the policy at some future date or a term policy may reach its expiry date, where the carrying value may no longer be recoverable.
 - For policies where the carrying value reaches the face amount, the carrying value would not be fully recoverable. No outside entity would pay the carrying value (face of the policy) for the right to continue paying premiums and ultimately only receive the face of the policy. Since providers are not able to obtain fair market values on owned policies (due to the lack of up-to-date underwriting information), the only external value for the policy would be the insurer's cash surrender value.
- Under the accounting proposed in the FSP there is an incentive to keep a life settlement contract in-force, even if the economics of the policy may indicate that no future premiums should be paid and that the policy should be lapsed. This is because at the time the decision is made to lapse the policy, the capitalized cost would be expensed with no related revenue to be recognized resulting in an immediate loss. The write-off of the capitalized cost of the policy could be delayed at the option of the life settlement provider by continuing to pay premium on the policy.

Proposed alternative method: We propose the following alternative method for your consideration -

Capitalize both the cash surrender value of the underlying policy and the excess of the purchase price over the cash surrender value, with the excess purchase price expensed over the life expectancy of the insured.

The amount paid to buy the life settlement contract would be bifurcated into two components -a) the payment for the cash surrender value of the policy at the point of purchase and b) the amount paid in excess of the cash surrender value. The cash surrender value would remain as an asset on the books. The periodic premiums paid would be expensed as a period cost. Simultaneously, the change in cash surrender value or contract value during Mr. Larry Smith Financial Accounting Standards Board Page 3

the period would be an adjustment to the premiums paid. When the insured dies or the policy endows, the difference between the face value of the policy and the carrying value is recognized into income. If the policy is lapsed, no revenue would be recognized and the carrying value is expensed.

The excess of the purchase price over cash surrender value would be treated as deferred acquisition cost, and would be capitalized and amortized over the life expectancy of the insured to reflect the economic substance of the policy. Precedence exists in the current accounting literature of insurance companies for capitalizing and amortizing policy acquisition costs (SFAS 60). When the insured dies, the policy endows or the policy is lapsed, the unamortized balance of the deferred acquisition cost is written off immediately.

This proposed alternative method may be easily incorporated into the existing FTB 85-4, with two modest changes. First, the excess of the purchase price over the cash surrender value would be capitalized at the time of purchase. Second, this excess purchase price would be amortized over the life expectancy of the insured.

By revising the existing FTB 85-4, there is consistency between corporations holding key man insurance and life settlement providers holding existing policies. Since corporations (for key man insurance) purchase the insurance coverage at the issuance of the policy, there is no excess purchase price and such corporations would not be affected by these additions to the existing FTB 85-4.

This method allows for:

- The carrying value of the life settlement contract to be more representative of its realizable value, better reflecting the economic substance of the life settlement contract.
- Capitalizing the amount paid at the point of purchase in excess of the cash surrender value and systematically amortizing based upon the insured life expectancy.
- Expensing of the mortality charge component of each premium payment.
- Consistent accounting for all enterprises owning life insurance contracts.
- Easily auditable asset values, straightforward and easy to apply.

Impairment Test

One impairment approach that could be taken would be to test the original purchase price against current assumptions. If a shift in mortality assumptions occurred such that insureds are expected to live longer than the original assumptions, then the original purchase price could be recalculated as of the original purchase date using current assumptions. If the recalculated purchase price is less than the original purchase price, then this difference would be a current period impairment to the asset's carrying value.

A second impairment approach would be the same as the above method except that a new purchase price would be calculated in the current period. This calculation would be using the same discount rate as used in the original purchase price, along with the current mortality assumption and the current projection of future premiums. This new purchase price would be compared to the current carrying value (original purchase price plus cumulative Mr. Larry Smith Financial Accounting Standards Board Page 4

premiums paid). If the new purchase price is less than the current carrying value, the difference would be a current period impairment to the carrying value. This method would recognize the impairment of term policies that are approaching expiry.

Both impairment approaches noted above could be used with the proposed alternative.

Additional Resources

If the board would welcome more information about the operation of a life settlement provider, we offer the services of our CEO of Viaticus (Lew Nathan). Mr. Nathan is very familiar with the life settlement industry and provided similar information to various state regulators as the NAIC worked on revising their Viatical Settlement Model Regulation (which also covers life settlements). In addition, as a Fellow of the Society of Actuaries, Mr. Nathan is also familiar with the determination of purchase price, underwriting of life expectancy, and the life insurance policies.



Lawrence J. Boysen

cc: Mr. Lew Nathan

CEO & President, Viaticus, Inc. (A Life Settlement Provider)