

December 23, 2002

Ms. Linda MacDonald Project Manager Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Letter of Comment No: 90 File Reference: 1125-001 Date Received: 12/20/02

RE: File Reference 1125-001

Proposal on Principles-Based Approach to U.S. Standard Setting

Dear Ms. MacDonald:

The GAAP Financial Reporting Principles Subcommittee of the American Council of Life Insurers (ACLI) appreciates the opportunity to provide it's comments to the Financial Accounting Standards Board (FASB or Board) concerning the Proposal on Principles-Based Approach to U.S. Standard Setting (the proposal). ACLI is the principal trade association of life insurance companies, representing 399 members that account for, in the aggregate, 75 percent of the assets of legal reserve life insurance companies in the United States.

We commend FASB on its goal to improve the quality and transparency of financial reporting by instituting a principles-based approach to accounting standard setting. With the convergence efforts underway between FASB and IASB, we believe it would be appropriate to follow the lead of IASB and build the principles based on a foundation of guidance such as that contained in IAS 1. Conceptually, we are not adverse to a principles-based approach. However, we believe that the proposed approach would have a significant impact on reporting financial results, and it is unclear whether this change from the current rule-based approach would improve the quality and transparency of financial reporting.

Further, such a substantive change in accounting practice may be ill timed in the context of challenges in the current accounting and reporting environment. The proposed approach provides less interpretive and implementation guidance for applying the standards, thereby increasing the need to use professional judgment focusing on the economics of the transaction. We are concerned that the approach discussed in this proposal could lead to situations in which professional judgments, made in good faith, are second-guessed by users of financial statements, as well as by the Securities and Exchange Commission (SEC), auditors and/or investors. In the current litigious environment, accounting professionals will be put in a difficult position.

We suggest an important first step in the process of implementing the proposed principles-based approach will be the development of a clear conceptual framework for the approach. This framework must be completed prior to actual implementation of the approach in order to preserve comparability and reliability.

Currently we are not in a position to fully support the concept of a principles-based approach to standard setting, although we would reserve our judgment until such time that a clear and complete framework is presented. If FASB decides to proceed with this approach, we would recommend that the practical application of such a model be addressed through field-testing the approach with different industry groups.

We submit the following responses to the questions posed in the proposal and offer our additional comments on issues that need consideration:

Question 1: Do you support the Board's proposal for a principles-based approach to U.S. standard setting? Will that approach improve the quality and transparency of U.S. financial accounting and reporting?

ACLI Comment: As previously stated, while we support the concept of a principles-based approach to U.S. standard setting, we cannot support the proposal in its current form and in the current environment. Regarding the quality and transparency of financial accounting and reporting, we are concerned about comparability. The primary qualities of credible and understandable financial statements are relevance and reliability. Relevance and reliability are founded on comparability and consistency, which significantly contribute to the usefulness of information. Comparability and consistency of financial information will likely be reduced, rather than improved, as not all companies and/or auditors would apply the same judgment and reach the same conclusions to similar transactions. While the goal of principles-based standards may be to place a greater burden of accountability on the preparers of financial statements, this approach may invite a level of interpretation and judgment into any given issue that will inherently result in a reduction of comparability and consistency across industries and companies.

Question 2: Should the Board develop an overall reporting framework as in IAS 1 and, if so, should that framework include a true and fair view override?

ACLI Comment: Yes, we believe that the Board should develop an overall reporting framework similar to that in IAS 1. The development of accounting standards with principles that apply more broadly than under existing accounting standards would require a conceptual framework that is complete, internally consistent, and clear. Thus, the Board would need to commit resources to a project to improve the conceptual framework. This framework needs to be reliable to ensure that consistency is achieved. We believe that it is important that this conceptual framework be completed before the Board attempts to issue accounting standards utilizing a principles-based approach.

We also believe that the framework should include a true and fair view override to be used in those extremely rare circumstances in which compliance with the requirement would be misleading.

Question 3: Under what circumstances should interpretive and implementation guidance be provided under a principles-based approach to U.S. standard setting? Should the Board be the primary standard setter responsible for providing that guidance?

ACLI Comment: The main reason for interpretive and implementation guidance in accounting standards is to ensure some level of comparability, that is, that certain similar transactions and events are accounted for similarly. That guidance can also be provided as an educational tool.

Interpretive and implementation guidance should be provided for all Standards to ensure completeness and clarity. We expect this will be particularly important for specialized industries and unique transactions and products (such as insurance contracts). For example, the guidance could contain examples of application of the Standard. The risk is that, absent such guidance, entities might select accounting methods that are not consistent with the intent and spirit of the Standards.

We do believe that the Board should be the primary standard setter for providing that guidance. This would provide some continuity to the profession during a time of substantial change. We would recommend the establishment of a task force such as the Emerging Issue Task Force to respond to issues more quickly than would be possible by the Board. The structure of this task force could possibly include sub-groups to handle specific industry related issues.

Question 4: Will preparers, auditors, the SEC, investors, creditors, and other users of financial information be able to adjust to a principles-based approach to U.S. standard setting? If not, what needs to be done and by whom?

ACLI Comment: In order to adjust to a principles-based approach, it is important that the preparers and auditors of financial statements receive the proper education and training. An education and training program would have to be developed and subsequently implemented at both the professional and college level.

This approach would require more coordination between the entity and its auditor to consider whether the accounting suggested is consistent with the underlying principle. This approach requires a strong commitment from both preparers and auditors. A principles-based approach to standard setting would require changes in the processes and behaviors of all participants in the financial accounting and reporting process, not just FASB and other standard-setting bodies. This approach will not work without these commitments.

We are very concerned with the potential litigation matters that may arise with the implementation of a principles-based approach, in particular, potential SEC enforcement actions. The potential for litigation will very likely affect the extent to which preparers and auditors are comfortable applying professional judgment. The ability of the SEC to address these concerns will be critical in order for a principles-based approach to work. Additionally, class action lawsuits are a potentially significant risk in the event that an entity encounters problems and the accounting policies are blamed for misrepresenting the facts. In hindsight, these facts can appear very different from when the original judgments were applied.

Question 5: What are the benefits and costs (including transition costs) of adopting a principles-based approach to U.S. standard setting? How might those benefits and costs be quantified?

ACLI Comment: We cannot quantify the benefits and costs of adopting this approach until the complete framework is developed. Once developed, and we can understand the transition that will be required, we will be in a better position to make this determination.

Entities can expect to incur additional costs related to increased time spent by their auditors and in-house personnel assessing the accounting treatment for items not clearly addressed in the principles-based guidance and providing additional disclosure regarding such judgments in the financial statements. Additional cost will also be incurred in retraining employees responsible for financial statement preparation and review with respect to application of the new approach. Furthermore, entities can expect to incur additional time in educating financial statement users, rating agencies and analysts regarding the content of the financial statements.

Question 6: What other factors should the Board consider in assessing the extent to which it should adopt a principles-based approach to U.S. standard setting?

ACLI Comment: The Board should consider how the adoption of this approach would affect projects that are currently in process, as well as those that have been finalized but have not yet reached their effective date.

Additional Comments:

If the Board proceeds with a principles-based approach, and, in connection with this effort, revisits the principles underlying the accounting by insurance enterprises, we believe an appropriate accounting model for the insurance industry should have the following characteristics:

- The model should recognize that assets are purchased to support liabilities, and that
 changes in market conditions should not materially affect earnings and capital of
 companies with appropriately matched durations of assets and liabilities.
- The model should employ a balanced approach wherein assets and liabilities are
 measured and reported in a manner that is meaningful in the context of the nature of the
 enterprise, and
- The model should rely on the statement of operations as a measure of the entity's performance.

Financial statements of life insurance companies must not only serve investors, but also consumers and regulators. We would not support a change to a different set of underlying insurance accounting principles without a meaningful demonstration of how that change would improve the usefulness and understanding of the financial statements of the life insurance industry.

Conclusion:

Conceptually, ACLI is not averse to a principles-based approach. However, at this time, ACLI cannot fully support the proposed approach to U.S. standard setting, due to the significant issues and concerns which we believe must be addressed by the Board prior to implementation of such an approach, including:

- Creation of a clear conceptual framework on which to base development of principlesbased standards
- Demonstration of the relevance, reliability, and comparability of the approach
- Transition time and treatment for the new approach (i.e. prospective or retroactive application)
- Education and training issues

- · Professional liability concerns
- Mediation involving disputes among interpretations by preparers and users, auditors or regulatory bodies

Further, as stated previously, such a substantive change in accounting practice may be ill timed in the current accounting and reporting environment. We would encourage FASB to continue its efforts to obtain feedback from users of financial statements (i.e., analysts, investment houses, rating agencies, and brokers) as to the usefulness of a principles-based approach and how it should be implemented. Also, as previously indicated, we would encourage FASB to test the operationality of the proposed requirements by working with different industry experts.

Sincerely,

James F. Renz

Senior Accountant American Council of Life Insurers 101 Constitution Ave. NW Washington, DC 20001 jimrenz@acli.com

T: 202-624-2168 F: 202-572-4849