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August 8, 2008

Mr. Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

1600-100

LETTER OF COMMENT NO. 192

ATTN: Technical Director
Re: File Reference No. 1600-100

Dear Mr. Herz:

The undersigned six insurance trade organizations, listed below, appreciate the opportunity to comment on the Exposure Draft of the Proposed Statement of Financial Accounting Standards, *Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R)* (Exposure Draft or Proposed Standard).

- The American Council of Life Insurers (ACLI) is a trade association with 353 member companies that account for 93 percent of the life insurance industry's total assets in the United States, 93 percent of life insurance premiums and 94 percent of annuity considerations. ACLI member companies are leading providers of retirement and financial security products, including life, disability income, and long-term care insurance; annuities; reinsurance; IRAs; and pensions such as 401(k), 403(b), and 457 plans.

- The American Insurance Association (AIA) is a property and casualty insurance trade organization representing 350 insurers that write more than $123 billion in premiums each year. AIA member companies offer all types of property and casualty insurance, including personal and commercial auto insurance, commercial property and liability coverage for small businesses, workers' compensation, homeowners' insurance, medical malpractice coverage, and product liability insurance.

- The Group of North American Insurance Enterprises (GNAIE) consists of the eighteen leading insurance companies including life insurers, property and casualty insurers, and reinsurers. GNAIE members include companies who are the largest global providers of insurance and substantial multi-national corporations. All are major participants in the U.S. markets.

- The National Association of Mutual Insurance Companies (NAMIC) is a full-service national trade association serving the property and casualty insurance industry with more than 1,400 member companies that underwrite more than 40 percent of the property and casualty insurance premium in the U.S. NAMIC members are small farm mutual companies, state and regional insurance companies, risk retention groups, national writers, reinsurance companies, and international insurance giants.

- Property and Casualty Insurers Association of America (PCI) is a property and casualty insurer trade association, representing over 1,000 companies that write 41 percent of the nation's automobile, homeowners, business, and workers' compensation insurance.

- The Reinsurance Association of America (RAA) is a non-profit trade association of property and casualty reinsurers and reinsurance intermediaries. RAA underwriting members and their affiliates write more than two-thirds of the gross reinsurance coverage provided by U.S. professional reinsurance companies.

We support the Board's commitment to provide financial statement users with transparent, timely and useful financial information. However, we oppose the Proposed Standard and urge the Board to retain the current model of disclosure set forth in FASB Statement No. 5, *Accounting for Contingencies* (SFAS 5) as the better approach toward achieving the Board's expressed goals. The Proposed Standard will produce precisely the results that its authors seek to avoid – disclosures that provide misleading information. In so doing, it would also needlessly compromise legal rights and obligations of insurers and policyholders enshrined in federal and state law and upheld by our nation's highest courts. By contrast, the existing SFAS 5 provides for the appropriate disclosure of transparent, timely information without jeopardizing substantive legal rights. We detail below the gravity with which we regard the Proposed Standard and the basis of our support for continued reliance on SFAS 5.

QUANTITATIVE DISCLOSURE

The Exposure Draft provides that under the current standard, "[t]he option to state that 'an estimate of the possible loss or range of loss cannot be made' is exercised with such frequency by financial statement preparers that users often have no basis for assessing an entity's possible future cash flows associated with loss contingencies." However, this inability to assess future cash flows associated with loss contingencies is a function of the fundamentally uncertain nature of litigation rather than an infirmity with SFAS 5. The Proposed Standard does not (and perhaps cannot) address this issue.

The Proposed Standard would require the following quantitative disclosures about the reporting entity's exposure to loss from the contingency:

1. The amount of the claim or assessment against the entity (including damages, such as treble or punitive damages), if applicable; or
2. If there is no claim or assessment amount, the entity's best estimate of the maximum exposure to loss.

In addition to the above, the Proposed Standard provides that a reporting entity may also disclose its best estimate of the possible loss or range of loss if it believes that the amount of the claim or assessment or the maximum exposure to loss is not representative of the reporting entity's actual exposure.

Both of these proposed alternatives disregard the practical and legal realities of the litigation process. With respect to the first proposed requirement, it should be noted that the amount of the claim or monetary relief sought by plaintiffs is often *not* set out in a complaint and thus simply does not exist for purposes of public disclosure. In addition, the amount the plaintiff demanded in a complaint bears no relationship to the reporting entity's ultimate loss. For example, an independent study conducted by Cornerstone Research, *Securities Class Action Settlements—2007 Review and Analysis,* contains a chart of median settlements as a percentage of estimated damages by damage range (page 6 of the study). The chart shows that, based on a sample of 812 settlements during the period 1996 through 2006, the median settlement was 3.6% of the estimated damages and during 2007, the median settlement was 2.9% of the estimated damages based on a sample of 111 settlements. It is easy to understand why this is so – from a plaintiff's perspective, a court would be unlikely to award damages beyond the extent to which the plaintiff believes it has been damaged. Consequently, it is in a plaintiff's opportunistic interest to raise the amount of a claim.

Lengthy discovery processes, testimony provided under oath at trial, and considerations by both judges and juries as to the identification of pertinent evidence frequently produce results that bear no resemblance to allegations of liability and damage set forth in a complaint. Disclosure of this amount provides misleading information to potential and current investors because actual exposure is often dramatically less.

The second proposed alternative – *estimate the maximum exposure to loss* – potentially is more problematic. Again, it provides the financial statement user with misleading information about the reporting entity's likely exposure, since maximum exposure is not the same as likely exposure and does not *achieve the goal of providing reliable information to assist users of the financial statements in assessing* the likelihood, timing, and amount of future cash flows associated with these contingencies. Given the nature of legal contingencies, this information is likely to be speculative and imprecise, and it could result in volatile disclosures as circumstances change in the dynamic course of legal proceedings. The path of a lawsuit is never predictable, changing quickly and frequently while the case is pending. What might appear to be a legitimate estimate one day could prove to be completely misleading as the case progresses. As a result, measuring litigation exposure under the Proposed Standard creates a substantial risk of error.

Not only do the proposed requirements risk the disclosure of misleading and outdated information, they also could subject companies and investors to other significant harm. Deviations from a reporting entity's estimate of maximum exposure could be construed as the making of materially false or misleading statements. Because the proposed disclosure requirements depend upon the reporting entity's *perception of exposure*, plaintiffs will have an opportunity to value their cases aggressively and to track a reporting entity's assessment of its case through adjustments to its exposure estimates, notwithstanding the proposed prejudicial exemption (discussed in detail below). Furthermore, the reporting entity's perception of exposure, as disclosed through its estimate of maximum exposure, risks waiver of the attorney-client privilege and discovery of materials developed in anticipation of litigation (information protected by the work product doctrine), raising fundamental due process concerns for insurers as well as their policyholders.

The Board has requested comment on whether or not settlement offers should be disclosed. We oppose in the strongest possible terms any disclosure of settlement offers. These figures are inherently misleading as a measure of loss. The amount of a claim is often a negotiation point, a starting point offered in a fluid and confidential forum. Settlement negotiations are confidential in order to promote candid and productive resolution. A requirement to disclose settlement offers will stifle candid negotiations, making it more difficult to reach settlement in some matters, and it will breach the confidential nature of settlement discussions, possibly subjecting the reporting entity to penalties.

The existing SFAS 5 requires disclosure of the estimate of the possible loss or range of loss or to state that such an estimate cannot be made. *It continues to be the best disclosure criteria.*

TABULAR RECONCILIATION

The Proposed Standard requires the reporting entity to "perform a tabular reconciliation of recognized loss contingencies," which includes disclosure of accruals, changes in accruals, and settlements paid. We have several concerns with this proposed requirement. First, requiring public disclosure of accruals could provide opposing counsel with the exact amount the reporting entity has put aside to satisfy a particular case, providing valuable information to opposing counsel, while disadvantaging the legal posture of the reporting entity. The Board's Prejudicial Exemption and the provision allowing aggregation do not alleviate this problem (discussed in detail below). The proposed tabular reconciliation requirement would encourage opposing counsel to increase the value of the case and possibly to pursue more litigation that otherwise would not have been brought. Even at a highly-aggregated level for a large company involved in a significant number of proceedings, we are concerned that opposing counsel could analyze facts about a proceeding available in the public domain (e.g., date of filing a claim, nature of the claim, amount of the claim), together with information disclosed in the financial statements and periodic changes in those disclosures, and reach conclusions that could affect, to the reporting entity's detriment, the defense of the proceeding and the outcome of the contingency. We also are concerned that insight into the reporting entity's legal strategy could be gleaned from such information much more often than "rarely" as the Proposed Standard concludes.

In addition, this information is not useful to the financial statement users. Aggregating unique liabilities, as is allowed by this requirement of the Proposed Standard, does not provide a historic pattern for reliable insight because they would lack homogeneity and a comparable basis. This point is especially true for litigation contingencies, where each case presents a unique fact pattern that cannot be used to draw correlations to other cases. It should be noted that disclosure of aggregated litigation amounts will likely make the non-aggregated information subject to discovery.

Finally, similar to the concerns outlined above in the "Quantitative Disclosure" section, the proposed requirement that the reporting entity disclose the amounts accrued will inevitably require disclosure of attorney-client communications and materials developed in anticipation of litigation (information protected by the work product doctrine). For these reasons the tabular reconciliation proposal should be rejected.

PREJUDICIAL EXEMPTION

The Proposed Standard includes exemptions for prejudicial information "for instances in which an entity concludes that disclosing quantitative or qualitative information about a loss contingency as required by this Proposed Standard, either separately or aggregated by the nature of the contingency, would be prejudicial to its position in a dispute (that is, disclosure of the information could affect, to the entity's detriment, the outcome of the contingency itself)." This exemption is presented by the Board as a compromise between the interests of the reporting entity and those of the financial statement users. However, we disagree that this exemption is a viable compromise.

First, the ability to aggregate the enhanced disclosures required by the Proposed Standard is an illusory shield. Knowledge that the information has been aggregated also is knowledge that the information exists in its non-aggregated form. There is no apparent ability to shield the non-aggregated information, once it is developed for financial reporting purposes, from the reach of discovery and exploitation by the opposing party. Again, this would result in the disclosure of information protected by the attorney-client privilege, likely resulting in a waiver of privilege and in the disclosure of materials developed in anticipation of litigation (information protected by the work product doctrine). As the option to aggregate the information continues to be prejudicial by its very nature, the next option allowed by the Proposed Standard, to omit disclosures entirely, would be necessary more often than the "rare" use that the Board expects.

Second, there are flaws with the aggregation process, given the lack of clarity in the Proposed Standard as to what constitutes the "nature of the contingency". For example, it is unclear how similar the claims must

be in order to be aggregated. For a relatively small number of entities, aggregation of all litigation claims might afford the reporting entity some protection. For the majority of entities, however, there may not be enough material litigation or contingencies accrued (as applicable to the tabular reconciliation requirements) that meets the disclosure threshold, in order for aggregation to provide the protection of masking the details of the underlying claims, as the Proposed Standard suggests. Careful tracking of the periodic changes in the aggregated loss contingencies can provide plaintiffs with confidential and highly prejudicial information. For example, with regard to the tabular reconciliation, if the aggregated loss reserve at the end of the second quarter were $25 million and the aggregated loss at the end of the third quarter increased to $35 million, opposing counsel could conclude that, for example, the court's denial of the reporting entity's motion for summary judgment has caused the reporting entity to add $10 million to its loss reserve. That information, in turn, could provide opposing counsel with an advantage in settlement negotiations that will ultimately affect the outcome of the case and increase the losses to the reporting entity and its shareholders.

Exacerbating this problem is the requirement for entities with quarterly financial reporting requirements to disclose this information more frequently than annually. The added frequency of disclosure only enhances the ability of opposing counsel to isolate information relating to the case. *

EXPECTED INSURANCE RECOVERIES/INDEMNIFICATIONS

SFAS 5 language states, "[a]dequate disclosure shall be made of contingencies that might result in gains, but care shall be exercised to avoid misleading implications as to the likelihood of realization." The Proposed Standard requires the disclosure of "relevant insurance or indemnification arrangements that could lead to a recovery of some or all of the possible loss." This language is troublesome as it contradicts SFAS 5's logical statement that "care shall be exercised to avoid misleading implications as to the likelihood of realization." To require disclosure of insurance recoveries/indemnification may mislead investors into thinking the likelihood of realization is close to certain.

From a litigation perspective, insurance carriers typically will not move beyond a reservation of rights letter until the litigation is substantively resolved. Disclosing the amount would imply confirmation of coverage, which may not be the case. Additionally, disclosure of an expected recovery in cases where the reporting entity is denying liability creates a contradictory statement. This disclosure of an assessment of the reporting entity's likely recovery will also disclose information protected by the attorney-client privilege and will require disclosure of materials prepared in anticipation of litigation (information protected by the work product doctrine). Such disclosure would provide confidential and highly prejudicial information to opposing counsel, who then can use the reporting entity's expected recovery as a floor in attempting to negotiate a litigation settlement. Providing this information would damage a reporting entity's ability to defend itself in litigation and would increase the entity's exposure, harming current investors and policyholders through increased premiums. Therefore, the best solution is to retain the SFAS 5 concept that these disclosures are optional.

The complexity of providing litigation disclosure takes on added significance for both the insurer and its policyholder. Although insurance claims liabilities are scoped out of the Proposed Standard, it should be noted that policyholders would still be required to disclose their contingencies and potential insurance recoveries in their financial statements. For many types of insurance coverage, an insurer has an obligation to defend its policyholder in litigation. Forcing policyholders to disclose material elements of pending litigation would compromise the insurer's ability to defend the policyholder and, ultimately, would raise the cost of the claim, while providing little or no incremental value to investors.

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* In fact, as with many of the proposed requirements of the Proposed Standard, counsel for plaintiffs could be subject to malpractice claims if they did not aggressively track and isolate such information for the benefit of their clients.

DISCLOSURE THRESHOLD (SEVERE AND NEAR TERM)

The Proposed Standard requires loss contingencies within its scope to be disclosed, regardless of the likelihood of loss, if 1) the contingencies are expected to be resolved in the near term and 2) the contingencies could have a severe impact on the reporting entity's financial position, cash flows, or results of operations. This requirement could result in the inappropriate disclosure of remote contingencies. This threshold significantly alters the current SFAS 5 disclosure threshold and makes the filter for disclosure too permeable. A reporting entity should be given discretion to avoid disclosure of remote lawsuits with speculative damages claims in order to prevent the reporting of misleading information in the financial statements. Disclosure of these types of items is not meaningful to the financial statement users – transparency does not require knowledge that a frivolous lawsuit exists. Such disclosure could be misleading to financial statement users because it may present a distorted view of a reporting entity's liquidity, working capital, and financial position. It could also result in needlessly conservative investment decisions by potential investors because financial statement users would not be able to distinguish between those items that are likely to occur and those that are not likely to materialize. For these reasons, the SFAS 5 disclosure threshold is more appropriate and, therefore, should be retained.

EFFECTIVE DATE

In the event that the current SFAS 5 disclosure model is not retained (and we urge that it be retained), the effective date proposed in the Proposed Standard should be modified. We understand the Board's desire to propose an accelerated effective date for the final standard. However, we point out that an unusually large number of recently-issued standards that will impose significant accounting, reporting, and information systems changes on companies have effective dates of December 31, 2008 or January 1, 2009 for calendar year-end companies. In addition, the Board has exposed and plans to expose a number of proposed standards that are expected to have similar effective dates. Considering the incremental nature of the proposed disclosures and the significant effort financial statement preparers likely are making to prepare for adoption of other recently-issued and expected-to-be-issued standards with the same effective dates, the relatively short transition period to the proposed requirements is inadequate in light of the scope and nature of the disclosures and, therefore, should be extended. In fact, we would strongly suggest that, given the misgivings raised in this and other comment letters, the Board should provide itself with additional time to deliberate.

CONCLUSION

Although intended to provide users of financial statements with information to assist in assessing the likelihood, timing, and amount of future cash flows, the Proposed Standard overreaches. It will cause the reporting entity to disclose excessive, unreliable, even misleading information. Financial statement users will be inundated with unreliable information about "remote" contingencies and "maximum exposure to loss", causing them to have a skewed perception of a reporting entity's true exposure to loss. Therefore, financial statement users will be making investment decisions based on this misleading picture. The Board has substituted a perceived problem of financial statement users receiving insufficient information with the bigger problem of users receiving misleading information. In doing so, the required disclosures would no longer be historical and reasonably accurate, but rather they would constitute inaccurate and forward looking guesses. The Proposed Standard does not help investors; instead, it would ultimately hurt them by requiring disclosures that are not reliable. Furthermore, the disclosure of this information could be prejudicial to the reporting entity, even with the Board's prejudicial exemption.

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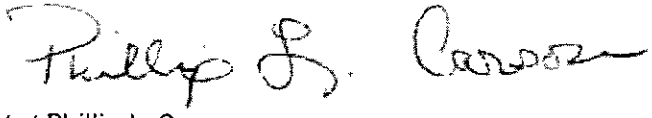
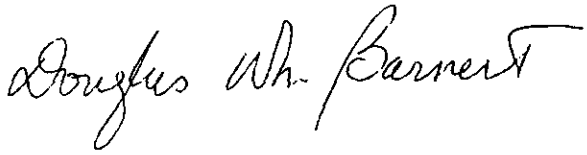
We appreciate the opportunity to provide the Board with comments during its redeliberations of the Proposed Standard. Please let us know if you have any questions or if we can provide additional information.

Respectfully,

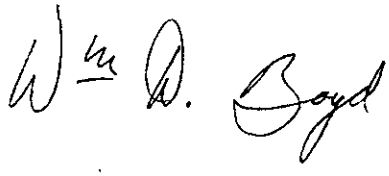
/s/ Michael Monahan
Director, Accounting Policy
American Council of Life Insurers



/s/ Phillip L. Carson
Assistant General Counsel
American Insurance Association

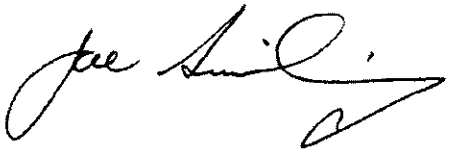


/s/ Douglas Wm. Barnert
Executive Director
Group of North American Insurance Enterprises



/s/ William Boyd
Financial Regulation Manager
Nationwide Association of Mutual Insurance Companies

/s/ James Olsen
Director, Insurance Accounting and Investment
Property Casualty Insurers Association of America



/s/ Joseph B. Sieverling

Senior Vice President and Director of Financial Services
Reinsurance Association of America