



September 28, 2009

Sir David Tweedie
Chairman, International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Exposure Draft 2009/5 – Fair Value Measurement

Dear Sir David,

The Group of North American Insurance Enterprises (“GNAIE”)¹ appreciates the opportunity to offer comments and observations about Exposure Draft 2009/5 – Fair Value Measurement (“ED”).

GNAIE supports the basic objectives of the ED, which include establishing a single source of authoritative guidance for all fair value measurements and enhancing disclosures about fair value to assist financial statement users in understanding how financial instruments are valued. While aligned with the basic objectives of the ED, we are concerned about certain requirements of the ED, including guidance to determine the fair value of financial assets associated with markets that were previously active but inactive (e.g., as determined based on the criteria set forth in paragraph B5 of the ED) at the financial reporting date. We believe the fair value of financial assets associated with markets that were previously active but are inactive at the financial reporting date should be measured using expected cash flows and appropriate discount rates that reflect the uncertainty related to the timing and amount of expected cash flows.

When markets that were previously active become inactive, transparent, market observable information typically does not exist to allow reporting entities, or financial statement users, to determine whether observed transactions are forced liquidations or distress sales. This lack of transparency into the motivations of buyers and sellers and the terms of observed (and typically isolated) transactions in inactive markets makes it impossible to definitively determine whether they represent transactions between willing buyers and willing sellers or forced liquidations or distress sales. Accordingly, we believe these transactions should not be considered determinative in the measurement of fair value. In contrast, we support an approach where, once a market that was previously active is determined inactive, **all transactions** associated with that market would be considered **disorderly** and fair values would be determined using expected cash flows and appropriate discount rates commensurate with the uncertainty related to the timing and amount of expected cash flows and would not reflect severe liquidity discounts associated with transactions in the currently inactive market for the financial instrument reflecting the absence of traditional market participants unwilling to transact at liquidation values.

¹ GNAIE is a trade organization comprised of 19 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, and all are major participants in the US markets.

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We believe all transactions associated with previously active markets determined inactive at the financial reporting date are disorderly and consequently the determination of fair value should be completed using an in-exchange valuation premise and an income as opposed to transactional approach as described above. In support of our view, we consider paragraph 1 of the ED which defines fair value as, “*The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction [emphasis added]** between market participants at the measurement date*”. Paragraph 8 of the ED goes on to say that, “*A fair value measurement shall assume the transaction to sell the asset or transfer the liability takes place in the most advantageous market to which the entity has access*”. Paragraph 11 goes on to say that “*In the absence of evidence to the contrary, an entity may assume the principal market for the asset or liability is the most advantageous market, provided the entity can access the principal market*”. We believe that when the principal market for a financial instrument that was previously active becomes inactive, it is not possible to determine whether observable transactions in those markets are orderly transactions (i.e., not forced liquidations or distress sales) and thus the most advantageous market should be a hypothetical market where market participants transact at values determined through application of a valuation technique other than one that uses the quoted price associated with an inactive market. In these situations, we are supportive of applying an in-exchange valuation premise and an income approach utilizing expected cash flows and appropriate discount rates commensurate with the uncertainty related to the timing and amount of expected cash flows.

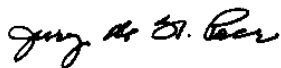
While one may suggest our proposed approach allows significant “management judgment” and “reduces transparency”, we believe the alternative (i.e., relying on transaction prices in inactive markets) provides financial statement users with relatively no transparency into the valuation of affected financial instruments. To balance the use of greater management judgment, we recognize the need for disclosures that provide sufficient “transparency” into how model input assumptions are derived and information about the validity of model inputs when modeled financial assets are sold or otherwise disposed of.

In addition to concerns about the fair value measurement of financial instruments associated with previously active markets that are inactive at the financial reporting date, we also do not support determining the fair value of financial instruments as the sum of (a) fair value based on their current use and (b) any incremental fair value attributable to their highest and best use. More specifically, we believe financial statement users are primarily interested in the expected future cash flows generated by financial instruments. Accordingly, if they are valued in a manner inconsistent with how they are used the information provided to financial statement users about expected future cash flows would not be decision-useful.


In summary, GNAIE believes the fair value of financial assets determined by reference to transactions in markets that were previously active but have become inactive at the reporting date should be determined using a valuation technique (i.e., income approach) as described herein. Our views are influenced by the fact that it is not possible to reliably determine whether transactions in inactive markets are orderly. Accordingly, fair value should be determined using an in-exchange valuation premise and an income approach utilizing expected future cash flows and appropriate discount rates commensurate with the uncertainty related to the timing and amount of expected cash flows (but not reflective of severe liquidity discounts associated with transactions in the currently inactive market for the financial instrument).

If the Board desires a further discussion of our views please contact Kevin Spataro at (847) 402-0929. In addition, by way of this communication, GNAIE would like to participate in the Fair Value Measurement Roundtable planned for Norwalk, CT on November 2, 2009.

Sincerely,

A handwritten signature in black ink, appearing to read "Jerry de St. Paer".

Jerry de St. Paer
Executive Chairman

A handwritten signature in black ink, appearing to read "Kevin Spataro".

Kevin Spataro
Chairman, Accounting Convergence Committee

Question 1

The exposure draft proposes defining fair value as ‘the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date’ (an exit price) (see paragraph 1 of the draft IFRS and paragraphs BC15–BC18 of the Basis for Conclusions). This definition is relevant only when fair value is used in IFRSs.

Is this definition appropriate? Why or why not? If not, what would be a better definition and why?

We believe the proposed definition of fair value (i.e., “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”) is appropriate in situations where markets are active (i.e., they are “functioning in their normal state”).

In situations where markets are inactive and not functioning in their normal state (i.e., there has been a significant decline in the level of market activity as compared to the normal state of the market) fair value should be determined using a valuation technique (i.e., income approach) that considers **expected cash flows and appropriate discount rates** that reflects the value that would be realized by market participants in transactions assuming the market functions in its normal state. When markets that were previously active become inactive the principal catalyst of inactivity is typically the absence of traditional market participants unwilling to transact at liquidation values.

We believe a requirement to value securities associated with markets that were previously active but are inactive at the financial reporting date under current market conditions is equivalent to requiring the use of liquidation values which we do not believe are consistent with the basic notion of fair value. Moreover, this requirement has highly pro-cyclical effects in that recognizing the declines in fair value causes lower levels of transactional volume and ever lower fair values as traditional market participants refrain from participation in the inactive market. Given the G-20’s desire to reduce pro-cyclicality in the financial markets we believe our proposal to use an income approach to value financial assets in the circumstances described would be consistent with the G-20 recommendations.

Question 2

In three contexts, IFRSs use the term ‘fair value’ in a way that does not reflect the Board’s intended measurement objective in those contexts:

- (a) In two of those contexts, the ED proposes to replace the term ‘fair value’ (the measurement of share-based payment transactions in IFRS 2 Share-based Payment and reacquired rights in IFRS 3 Business Combinations).
- (b) The third context is the requirement in paragraph 49 of IAS 39 Financial Instruments: Recognition and Measurement that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. The exposure draft proposes not to replace that use of the term ‘fair value’, but instead proposes to exclude that requirement from the scope of the IFRS.

Is the proposed approach to these three issues appropriate? Why or why not? Should the Board consider similar approaches in any other contexts? If so, in which context and why?

We support the Board’s proposal in these special situations. In addition, if the Board does not accept our proposal concerning the measurement of the fair value of financial instruments associated with markets that were previously active but are inactive at the financial reporting date, an alternative would be to consider this a “special situation”. More specifically, if the Board believes the use of the in-exchange valuation premise and the income approach is inconsistent with calibration to a transaction price in the **most advantageous market**, which may be a market that has migrated from active to inactive, we suggest creating an exception so as not to require the use of liquidation values for certain financial instruments as described.

Question 3

The exposure draft proposes that a fair value measurement assumes the transaction to sell the asset or transfer the liability takes place in the most advantageous market to which the entity has access.

Is this approach appropriate? Why or why not?

We believe the requirement that the transaction to sell the asset or transfer the liability take place in the most advantageous market to which the entity has access should be modified in those situations where the market is inactive and not functioning in its normal state (i.e., there has been a significant decline in the level of market activity as compared to the normal state of the market). In those situations, we believe fair value should be determined using a valuation technique (i.e., income approach) that considers **expected cash flows and appropriate discount rates** that reflect values that would be realized by market participants in transactions assuming the market functions in its normal state.

In BC40, the Board noted that most entities aim to maximize profits and therefore proposed that a fair value measurement should assume the sale of an asset or transfer of a liability takes place in the most advantageous market to which the entity has access. In the absence of evidence to the contrary, the ED indicates the reporting entity may assume the principal market for the asset is the most advantageous market provided it can be accessed. In situations where markets that were previously active become inactive, traditional market participants abandon the principal market as they are unwilling to transact at liquidation prices. Consistent with this observation, we believe the measurement of fair value should be modified in situations where markets migrate from active to inactive and traditional market participants refrain from transacting, and are not required to transact, at what they perceive to be liquidation values. In these situations, we believe fair value should be measured using an in-exchange valuation premise and an income approach as described above.

In contrast, a requirement to measure fair value as the price available in the most advantageous market, even if that market is inactive and traditional market participants are not accessing that market due to the existence of perceived liquidation values, would not be consistent with the basic notion of fair value which assumes an exchange between knowledgeable, willing parties in an arm's length transaction. We believe that when markets that were previously active become inactive, as evidenced by the absence of traditional market participants, the spirit and intent of an "exchange between knowledgeable, willing parties in an arm's length transaction" is not achieved and the measurement should be completed using an in-exchange valuation premise and an income approach as described as opposed to calibrating to prices of transactions in inactive markets.

Question 4

The exposure draft proposes that an entity should determine fair value using the assumptions that market participants would use in pricing the asset or liability.

Is the description of market participants adequately described in the context of the definition? Why or why not?

We do not believe the description of market participants is adequately described in situations where the market has migrated from active to inactive and is not functioning in its normal state (i.e., there has been a significant decline in the level of market activity as compared to the normal state of the market). In those situations (i.e., where traditional market participants exit the principal market due to an unwillingness to transact at liquidation values) the definition of a market participant should be modified to be consistent with the notion of the traditional market participant. Traditional market participants in these situations refrain from transacting, and are not otherwise required to transact at liquidation values, as those values are not

reflective of **expected cash flows and appropriate discount rates** that reflect the uncertainty related to the timing and amount of expected future cash flows.

In BC43, the Board defined market participants as independent of each other (they are not related parties), knowledgeable about the asset or liability, and able and willing to enter into a transaction for the asset or liability. We believe that in situations where markets migrate from active to inactive it is critical that the market participant notion focuses on traditional market participants as it is those participants that establish the fair value of the related financial instruments as opposed to the relatively limited number of entities willing to transact at liquidation values. We believe that measuring fair value based on the actions of the traditional market participants reduces pro-cyclicality as well as the opportunity for entities to manipulate markets with isolated transactions in inactive markets; the details of which are typically not transparent to other market participants.

Question 5

The exposure draft proposes that:

- (a) the fair value of an asset should consider a market participant's ability to generate economic benefit by using the asset or by selling it to another market participant who will use the asset in its highest and best use;
- (b) the highest and best use of an asset establishes the valuation premise, which may be either 'in use' or 'in exchange';
- (c) the notions of highest and best use and valuation premise are not used for financial assets and are not relevant for liabilities.

Are these proposals appropriate? Why or why not?

We do not support the first two proposals as they could lead to situations where a valuation may be based on a use of an asset that is other than the "current use" of the asset by the investor/reporting entity. Also see response to Question 6. In addition, we agree the notion of highest and best use is not relevant for financial assets and liabilities. That said, we believe the in-exchange valuation premise should be modified for financial assets associated with markets that were previously active but have become inactive at the financial reporting date inasmuch as the in exchange valuation premise should be required to be executed using an income approach that utilizes expected future cash flows and appropriate discount rates commensurate with the uncertainty related to the timing and amount of expected cash flows (but not reflective of severe liquidity discounts associated with transactions in the currently inactive market for the financial instrument).

Question 6

When an entity uses an asset together with other assets in a way that differs from the highest and best use of the asset, the exposure draft proposes that the entity should separate the fair value of the asset group into two components: (a) the value of the assets assuming their current use and (b) the amount by which that value differs from the fair value of the assets (ie their incremental value). The entity should recognise the incremental value together with the asset to which it relates.

Is the proposed guidance sufficient and appropriate? If not, why?

We do not support the proposed measurement of an asset in a manner that is inconsistent with the actual use of the asset at the measurement date. We understand the notion of highest and best use and believe it is an important notion when considering the valuation of assets. However, when assets have been employed in a specific manner the basis of their valuation should be consistent with the manner in which they are employed. In contrast, valuing assets specifically employed in a particular manner under the presumption that they are employed differently for purposes of valuation would produce fair values that are

not decision-useful to financial statement users. More specifically, financial statement users are most interested in the expected cash flows generated by assets and if they are valued in a manner that is not consistent with how they are used the information provided to financial statement users about expected cash flows would not be decision-useful.

Question 7

The exposure draft proposes that:

- (a) a fair value measurement assumes that the liability is transferred to a market participant at the measurement date;**
- (b) if there is an active market for transactions between parties who hold a financial instrument as an asset, the observed price in that market represents the fair value of the issuer's liability. An entity adjusts the observed price for the asset for features that are present in the asset but not present in the liability or vice versa;**
- (c) if there is no corresponding asset for a liability (e.g., for a decommissioning liability assumed in a business combination), an entity estimates the price that market participants would demand to assume the liability using present value techniques or other valuation techniques. One of the main inputs to those techniques is an estimate of the cash flows that the entity would incur in fulfilling the obligation, adjusted for any differences between those cash flows and the cash flows that other market participants would incur.**

Are these proposals appropriate? Why or why not? Are you aware of any circumstances in which the fair value of a liability held by one party is not represented by the fair value of the financial instrument held as an asset by another party?

We do not support the basic presumption in the first proposal due to the low frequency with which liabilities are transferred to market participants. In contrast, we would support the valuation of a financial liability based on the value of a corresponding instrument traded as an asset, adjusting for any features that are present in the asset but not present in the liability, or vice versa.

In the situations where there is no market or corresponding asset we do not support the estimation of fair value using models ahead of the completion of IAS 37 which we believe will be precedential in this area, once complete.

Question 8

The exposure draft proposes that:

- (a) the fair value of a liability reflects non-performance risk, i.e., the risk that an entity will not fulfill the obligation;**
- (b) the fair value of a liability is not affected by a restriction on an entity's ability to transfer the liability.**

Are these proposals appropriate? Why or why not?

We do not support including own credit risk in the valuation of liabilities due to the counter-intuitive and we believe non decision-useful results produced when including an issuer's own credit risk in the post-inception measurement of a liability because the issuer/reporting entity does not typically possess the intent or ability to early extinguish its debt (i.e., realize the theoretical mark-to-market adjustment) with the counterparty or to transfer the liability to another party at a value other than the contractual fulfillment value. We further contend that a counterparty/creditor would not accept a value other than the full value of the contractual obligation simply because the issuer's credit risk has changed or risk free interest rates have changed.

Question 9

The exposure draft lists four cases in which the fair value of an asset or liability at initial recognition might differ from the transaction price. An entity would recognise any resulting gain or loss unless the relevant IFRS for the asset or liability requires otherwise. For example, as already required by IAS 39, on initial recognition of a financial instrument, an entity would recognise the difference between the transaction price and the fair value as a gain or loss only if that fair value is evidenced by observable market prices or, when using a valuation technique, solely by observable market data.

Is this proposal appropriate? In which situation(s) would it not be appropriate and why?

We do not disagree with the proposal, however, we would stress that instances where the fair value of a financial asset or liability differs from the acquisition or issuance price at inception should be very limited. Moreover, given our views on the measurement of fair value in inactive markets, we would also suggest that if assets associated with an inactive market are acquired the initial and ongoing basis of valuation should be the acquired price and subsequent prices in the inactive market. That is, we would not support applying the measurement proposal for financial instruments associated with markets that were previously active but have become inactive as described in our response to questions 1, 3, and 4.

Question 10

The exposure draft proposes guidance on valuation techniques, including specific guidance on markets that are no longer active.

Is this proposed guidance appropriate and sufficient? Why or why not?

We agree with the guidance as it relates to assets associated with markets that are functioning in their normal state. In contrast, where markets that were previously active become inactive, we do not agree with the proposed guidance as we believe in these situations there should be a requirement to use an income approach when applying the in-exchange valuation premise to measure fair value as opposed to a market approach that calibrates to transaction values that are representative of liquidation values. We believe the income approach should rely on expected cash flows and appropriate discount rates during such time as the market in questions remains inactive. When markets that were previously active but become inactive, are restored to their previous level of activity, the use of the in-exchange valuation premise calibrating to current market transactions to measure fair value should be resumed.

Question 11

The exposure draft proposes disclosure requirements to enable users of financial statements to assess the methods and inputs used to develop fair value measurements and, for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

Are these proposals appropriate? Why or why not?

We do not believe these proposals are appropriate as they will be completely arbitrary by nature and thus very difficult to compare between companies. In addition, we are concerned with this type of judgmental information which typically resides in Management's Discussion & Analysis disclosures where they are protected by "safe harbor" rules being presented in financial statement footnotes and thereby being subjected to both audit and Sarbanes-Oxley Section 404 controls.



Question 12

The exposure draft differs from Statement of Financial Accounting Standards No. 157 Fair Value Measurements (SFAS 157) in some respects. The Board believes that these differences result in improvements over SFAS 157.

Do you agree that the approach the ED proposes for those issues is more appropriate than the approach in SFAS 157? Why or why not? Are there other differences that have not been identified and could result in significant differences in practice?

The issues identified in this comment letter are for the most part issues with both SFAS 157 as well as the ED.

