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December 4, 2008

Mr. Jim Kroeker  
Deputy Chief Accountant  
U.S. Securities and Exchange Commission  
100 F Street NE Washington, DC 20549

Re: File Number 4-573 – SEC Study of Mark-to-Market (“MTM”) Accounting

Dear Mr. Kroeker:

The Group of North American Insurance Enterprises (“GNAIE”)<sup>1</sup>, would like to thank you for the opportunity to participate in the MTM Roundtable on November 21, 2008.

We would like to again state very clearly that GNAIE fully supports the use of fair value as a measurement basis for financial instruments whenever active, liquid, orderly markets exist from which transparent and consistent market observable data (“MOD”) is available to validate prices either directly or indirectly. We believe this situation fulfills the basic requirements of the qualitative characteristics of financial information (i.e., relevance, reliability, comparability, and understandability).

Moreover, while we do not believe fair value measurements caused the Worldwide Credit Crisis (“WCC”); once it emerged, and an inactive, illiquid, and disorderly market ensued for certain securities; unreliable and non-transparent fair value measurements of those securities served as a powerful accelerant<sup>2</sup>.

GNAIE believes the fundamental shortcoming of FASB Statement No. 157, *Fair Value Measurements* (“SFAS 157”) relates to its application to certain illiquid securities including structured credit products (“SCP’s”) held in certificated form which are at the epicenter of the WCC. More specifically, we believe SFAS 157

<sup>1</sup> GNAIE is a trade organization comprised of 18 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.

<sup>2</sup> This assertion rests on the notion that levered financial institutions (e.g., broker-dealers, banks, and life insurers), historically a primary investor group for securitized debt instruments with loan related collateral, all but stopped making incremental investments in those instruments when they experienced a significant decline in fair value (largely attributable to liquidity spreads that increased to unprecedented levels) and previously active, liquid, and orderly markets for the instruments became inactive, illiquid, and disorderly. The unprecedented increase in liquidity spreads, price volatility, and corresponding decrease in fair value caused these asset types to become significantly out of favor, and despite seemingly attractive prices, there is little trading activity as financial institutions have avoided selling existing investments below internal estimates of economic value and adding to existing positions is not a viable alternative due to the volatile impacts on equity and solvency measures.

**GNAIE**  
Group of North American Insurance Enterprises  
40 Exchange Place, Suite 1707  
New York, NY 10005  
UNITED STATES

++1-212-480-0808  
info@insuranceaccounting.org  
www.insuranceaccounting.org

was pushed beyond its limitations as it does not produce reliable measurements representative of fair value (in the traditional sense of a willing buyer/willing seller) when markets are inactive, illiquid, and disorderly.

An example of the fundamental shortcoming with SFAS 157 involves situations where the condition of a market migrates from active, liquid, and orderly to inactive, illiquid, and disorderly, resulting in the unavailability of sufficient data to support reliable fair value measurements either on a direct or indirect basis. In these situations, applying the existing guidance in SFAS 157, using data from inactive, illiquid markets, results in measurements that we believe are more representative of *liquidation values* than fair value. The issue with these values is that they are fundamentally incompatible with financial statements presented on a going-concern basis, and with a reporting entity's intent and ability to hold such securities for the foreseeable future; which is typically the case with insurance companies.

We believe the severity of the current situation is largely attributable to SFAS 157's replacement of the basic notion of a "*willing buyer/willing seller in an arm's length transaction other than a forced or liquidation sale*" with the "*price received to sell an asset or paid to transfer a liability in an orderly transaction at the measurement date (i.e., exit value)*". In addition, the asset sale or liability transfer under SFAS 157 is a *hypothetical transaction*, not an actual transaction at the measurement date from perspective of market participant ("MP"). Accordingly:

- The SFAS 157 continuum is virtually infinite as it was intentionally designed to produce fair value measurements whenever required without the burden of a "willing buyer/willing seller" requirement; just a requirement to simulate a *hypothetical transaction* with all available information;
- While SFAS 157 includes the notion of an "orderly transaction", it refers specifically to *hypothetical as opposed to actual transactions*, as such there is no requirement for an orderly market or sustained, transparent, "market" activity to determine fair value; rather, just a need to develop a MP's view of exit value given all available information;
- In the current environment, certain SCP's are out of favor with investors (including a historical primary investor group – financial institutions such as banks, broker-dealers, and life insurers) as evidenced by liquidity spreads that have widened to unprecedented levels. Despite severe declines in market activity for certain SCP's, a MP estimate of exit value can nonetheless be determined as it represents a hypothetical transaction based on all available information. The question posed by GNAIE, however, is not whether a number can be assigned to exit value using the SFAS 157 paradigm, but rather whether the number assigned is:
  - **Relevant:** i.e., if the measurement represents a liquidation value, we believe it would be inconsistent with financial statements prepared on a going concern basis;
  - **Reliable:** i.e., if the MP view is derived from limited MOD its reliability may be difficult to independently validate;
  - **Comparable:** i.e., assuming limited MOD is available to directly or indirectly support an exit value measurement there is likely more variability, dispersion, and less consensus between estimates derived by unrelated MP's.

## GNAIE's Proposed Solution

GNAIE's proposal is one we believe can be implemented using existing mechanisms within US GAAP and can produce results that are sustainable in the longer term. More specifically, where markets for SCP's are no longer active, liquid, or orderly, thereby making it less likely that reliable fair values can be consistently derived on a direct or indirect basis, a "screen" would be added to SFAS 157. The screen would redirect SCP's held in certificated form, from the scope of SFAS 157 to other existing authoritative guidance applicable to the underlying collateral contained in the SCP's (which is often mortgage related but can also be consumer, auto, or other loan related products). Our basic proposal is thus to migrate from a fair value measurement under SFAS 157, but only in situations where markets are not active, liquid, or orderly, to an amortized cost/incurred loss measurement paradigm applied to identical loans outside the SCP's that are not held in securitized (or certificated) form. Notwithstanding our proposal to modify the measurement attribute from fair value to amortized cost, reporting fair values for affected securities would remain a footnote disclosure requirement for the benefit of financial statement users who wish to obtain the information regardless of its reliability.

## Specifics of GNAIE's Alternative Measurement Proposal

- SCP's associated with markets that are not active, liquid, or orderly, would be accounted for using existing authoritative accounting standards applicable to the SCP's underlying loans as if they were held in an un-securitized (i.e., whole loan) form by originators;
- Financial statement users would benefit from the alignment of the measurement attribute for loans held in securitized (or certificated) form when markets for the securitized (or certificated) assets are illiquid, inactive, or otherwise not orderly, with the existing measurement paradigm(s) applied to identical assets held in non-securitized (or non-certificated) form;
- Collateral supporting SCP's held in securitized (or certificated) form for which markets are no longer active, liquid, or orderly is typically loans (e.g., mortgage, consumer, etc.). The measurement attribute for loans in existing US GAAP is typically amortized cost. Underlying collateral would be aggregated and reported net of a valuation allowance determined under FASB Statement No. 5, *Accounting for Contingencies* ("SFAS 5") and impairment would be determined under FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan* ("SFAS 114") or other applicable standards;
- GNAIE's proposal would require essential amendments to SFAS 157, FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ("SFAS 115") and other relevant standards to redirect securities associated with markets that become inactive, illiquid, or disorderly to other existing measurement standards applicable to the underlying collateral when not held in securitized (or certificated) form.
- GNAIE's proposal would require development of a qualitative and/or quantitative guide to promote conformity around decisions of when markets migrate from being active, liquid, and orderly to inactive, illiquid and disorderly and back again;
- For SCP's held in securitized (or certificated) form, the investor would be required to provide a positive assertion as to its intent and ability to hold a security whose measurement attribute is

changed from fair value to amortized cost “for the foreseeable future” to eliminate any potential concerns about the non-recognition of unrealized losses;

- Transfers of SCP’s from a SFAS 115 available-for-sale (“AFS”) designation to an amortized cost paradigm outside SFAS 115 would be accounted for using the guidance in paragraph 15(d) of SFAS 115. As a result, any difference between fair value and amortized cost included as an adjustment of other comprehensive income (“OCI”) would be reversed over the remaining life of the security through the securities’ effective yield;
- Fair value would remain a footnote disclosure requirement for SCP’s whose measurement attribute is modified from fair value to amortized cost for the benefit of financial statement users who desire this information regardless of its reliability;
- Securities would be redirected back to SFAS 115 and 157 and measured at fair value if liquidity, activity, and order returns to the market. *This is consistent with GNAIE’s support for the use of fair value as a measurement basis when markets are active, liquid, and orderly;*
- A transfer back to AFS from amortized cost would be at the then existing fair value and AFS mechanics would resume.

## **GNAIE Views on Alternative Proposals and Other Considerations**

### ***Separation of Credit, Liquidity, and Interest Components of Fair Value***

We are aware of alternative proposals that would attempt to decompose market value changes into basic interest, credit, and liquidity components and have only the credit component recognized in the income statement with the other components affecting only OCI to the extent the reporting entity has the intent and ability to hold the affected securities to full recovery or maturity. We believe attempts to reliably separate the periodic changes in fair value associated with credit and liquidity would be severely challenged and do not believe that any such separation would be reliable or comparable between reporting entities.

To address the challenge of decomposing periodic fair value changes between credit, liquidity, and interest, some have suggested that the value assigned to credit be measured using a SFAS 5 incurred loss model. While we do support use of a SFAS 5 incurred loss model in situations where markets for SCP’s become inactive, illiquid, and disorderly, we would not support its use as a proxy for a periodic fair value change attributable to credit as we believe this would create an entirely new type of mixed attribute accounting model where fair value and amortized cost would be combined in such a way as to produce assets whose carrying value would become a new hybrid of fair value or amortized cost.

Notwithstanding our skepticism as to whether periodic changes in fair value can be reliably separated between credit, liquidity, and interest, there is also the fundamental issue that continuing to report securities at values that may be more akin to liquidation values than fair value would allow the highly corrosive impacts to shareholder’s equity to continue. We believe if this fundamental issue is not addressed, *and it is not addressed in this bifurcation proposal*, any further widening of

liquidity spreads and corresponding decreases in fair value would further weaken already weak financial services companies' equity capital and could be a catalyst for additional corporate failures.

### ***Introduce a Loan & Receivable Category to SFAS 115***

Some have suggested seeking better alignment between SFAS 115 and International Accounting Standard No. 39, *Financial Instruments: Recognition and Measurement* by introducing a Loan and Receivable category to SFAS 115 and then allowing reclassifications from SFAS 115 AFS to Loans and Receivables in situations where markets for SCP's with underlying loan collateral become inactive, illiquid, or disorderly. While we believe this could potentially produce results similar to GNAIE's proposal, we believe the proposal would be more difficult to introduce in the near term as its scope would need to be very carefully and narrowly defined and its interaction with other existing US GAAP standards that apply to un-securitized loans would need to be clarified.

### ***Transparency***

Throughout this intense debate, those who support the continuation of fair value measurements, even in situations where markets are inactive, illiquid, and disorderly, do so under the basic pretense that such information is relevant and provides the greatest degree of transparency to financial statement users. GNAIE believes the notion of transparency is being inappropriately referenced inasmuch as we do not understand how measurements derived from data obtained from inactive, illiquid, or disorderly markets can in any way be considered "transparent". Stated differently, assuming limited if any transparency into the limited transactions occurring in these markets that are inactive, illiquid, and disorderly, we do not understand how using the attributes of those "non-transparent" transactions as inputs in a SFAS 157 hypothetical transaction model can produce values that could, in any way, be described as transparent.

### ***The Purpose of Financial Reporting***

A separate but related topic that continues to influence the larger debate about the use of fair value as a measurement attribute relates to the basic purpose of financial reporting. GNAIE continues to believe the primary purpose of financial reporting is to provide financial statement users with relevant, reliable, comparable, and understandable information upon which they can make rational economic decisions about a reporting entity (i.e., whether to buy or sell common stock issued by the entity, to make a loan to the entity, or to engage in some other economic relationship). Accordingly, we believe financial statement users should be provided financial statements that have predictive value in terms of providing a reliable basis for decision making, which is fundamentally different than an objective of providing financial statement users with financial statements that are in and of themselves hypothetical predictions. In the current debate, the preceding is best illustrated by the difference between GNAIE's proposal to use amortized cost and an incurred loss model to value SCP's associated with markets that are no longer active, liquid, or orderly as opposed to estimating the exit value of such instruments by reference to a hypothetical transaction with inputs aligned to transactions where little transparency exists into how the prices were derived or the underlying transaction terms.



## Recommendation

Given the severity of the existing economic environment, we believe it is essential that regulators and standard setters work together to identify and implement practical solutions that will be effective as of December 31, 2008. Moreover, we believe the GNAIE proposal is one that is practical, easily implementable (as most of the necessary accounting and financial reporting infrastructure already exists), aligns with the direction the IASB appears to be headed on this issue, and is also conceptually sound. Given the critical importance of this issue, coupled with our belief that we have identified the most practical and implementable proposal, we offer our time and assistance to discuss the content of this letter or other issues or alternatives that may assist the Commissioners and Staff in indentifying and implementing a solution to the existing issues with SFAS 157 that would be effective as of December 31, 2008.

Sincerely,

A handwritten signature in black ink that reads "Kevin Spataro". The signature is written in a cursive, slightly slanted style.

Kevin Spataro  
Chairman, Accounting Convergence Committee  
Group of North American Insurance Enterprises, Inc.

KS:cll