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Ms. Florence Harmon
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Ms. Harmon:

The American Council of Life Insurers ("ACLI") appreciates the opportunity to comment on File No. 4-573, SEC Mark-to-Market Accounting Study (MTM Study). The ACLI represents three hundred fifty-three (353) member companies operating in the United States, of which three hundred forty-five (345) are legal reserve life insurance companies, and eight (8) are fraternal benefit societies. These 353 member companies account for 93 percent of total assets, 93 percent of the life insurance premiums, and 94 percent of annuity considerations in the United States.

The ACLI requests the SEC to work with the FASB to accomplish three objectives within a timeframe to provide guidance for companies prior to the close of the fourth quarter.

- First, we recommend that FAS 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115), be revisited by the FASB to be consistent with the revised guidance recently provided by the International Accounting Standards Board (IASB).
- Second, we recommend a revision of the requirements to recognize Other Than Temporary Impairments (OTTI) within the current guidance and alignment of the same with the guidance as provided by IASB.
- Third, FAS 157, *Fair Value Measurements* as amended (FAS 157), needs to be revised as it still does not adequately address the valuations of securities in disorderly or distressed markets even with the consideration of the recently issued FASB Staff Position No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP 157-3).

In addition to the recommendations listed above, we also have proposals that should be analyzed from a conceptual long-term basis:

- What impact does fair value have on financial statements in light of the credit crisis?
- What is the purpose of fair value?
- When is fair value appropriate?

FAS 115 Convergence with IFRS

The Held to Maturity (HTM) category of FAS 115 provides restrictive language that limits its use. Generally, our member companies acquire securities with the intent to hold them until maturity. These maturities are matched with the liabilities that the assets support. It is not unusual, though, to have duration changes in liabilities that require portfolio shifts to maintain asset/liability balances. To maintain the flexibility necessary to maintain asset/liability balances and the flexibility to maximize economic returns, and thus shareholder value, the use of the available for sale category in FAS 115 has been predominant, due to the limitations and restrictions placed on the use of the HTM category. The

IASB has recently provided a reclassification option within International Financial Reporting Standards (IFRS) that aligns with the option that exists within U.S. GAAP. However, inconsistencies remain as IFRS has a Loans and Receivables category (L&R) that is more appropriate for securities in inactive markets. Such a category does not exist under U.S. GAAP.

Specifically, IAS No. 39, *Financial Instruments: Recognition and Measurement* (IAS 39), contains the L&R category for financial instruments where an active market does not exist including both securitized and non-securitized financial assets accounted for as debt. Until recently, IAS 39 did not allow for reclassifications into or out of this category. However, given the recent market conditions, the IASB revised IAS 39 to allow for such transfers in circumstances that result in a change in condition of the underlying securities. The IASB publicly stated that the current market conditions are "rare" thus allowing reclassifications under this circumstance. Therefore, under IFRS, the market for mortgage-backed securities, for example, which once was an active market no longer meets the definition of active because regularly occurring transactions have ceased; IAS 39 now permits a reclassification of such securities to the L&R category. While U.S. GAAP provides for reclassification of securities between categories within FAS 115, it does not have a category that matches the L&R category of IAS 39. The L&R category allows a company to account for qualifying financial instruments at amortized cost without the liquidity restrictions of the HTM category within FAS 115. Furthermore, if an L&R impairment occurs, the losses are measured not from cost down to exit value, but down to the net present value (NPV) of expected future cash flows discounted at the loan's original discount rate, (currently suggested method for loans in FAS 114, *Accounting by Creditors for Impairment of a Loan*) which better reflects the economics of assets in this category than marking down to exit value. The FASB should review the provisions of IAS 39 and consider the addition of an L&R category within FAS 115 or a removal of the restrictive language within HTM to allow for more consistency in reporting between U.S. GAAP and IFRS filers. We would further recommend a transition period that permits companies to move securities into this category at July 1, 2008 in convergence with IAS 39. In lieu of requiring companies to restate third quarter earnings, we recommend allowing companies to use July 1, 2008 values applied prospectively within their fourth quarter earnings.

Recognition of Impairments – Revisions to OTTI and EITF 99-20

Significant differences exist between IFRS and U.S. GAAP in the recognition of OTTI. Given the acceptance of financial statements prepared using IFRS in the U.S.; we strongly believe that U.S. filers should not be disadvantaged by those differences between companies preparing financial statements using either of the two standards. U.S. GAAP filers are burdened by the intent and ability criteria requirement in FSP 115-1. This requirement in a period of high interest rates or wide credit spreads can lead to premature recognition of realized losses in the statement of earnings. While IFRS does require an intent and ability assertion for HTM securities, it does not for AFS. Most insurance companies in the U.S. primarily use the AFS category for the reasons stated above. We support a modification to U.S. GAAP to align with IFRS by removing the intent and ability to hold requirement and replacing it with an intent to sell requirement. We agree that a company that intends to sell a security should in that case recognize the realized loss associated with OTTI. This is consistent with other guidance within U.S. GAAP for assets held for sale as well as with IFRS.

We believe that the differences between U.S. GAAP and IFRS with regard to both the aforementioned FAS 115 categories and OTTI are substantial, cause significant differences between both net income and overall capital levels (in each case U.S. companies reflect more losses, negatively affecting reported capital positions) and should be aligned.

If the issues with FAS 157 as described below are not addressed, we recommend that the FASB modify FAS 115 and EITF 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial*

Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets (EITF 99-20), to use a basis other than FV for purposes of OTTI write-downs. We recommend that once a write-down is required, only the portion related to the credit loss be recorded through earnings. The remaining balance of the loss would still be reflected in OCI based on the value calculated in accordance with FAS 157. This is a view that was similarly articulated at the SEC Roundtable for MTM Accounting by a partner with PricewaterhouseCoopers, LLP. We recognize there could be practical issues with determining the credit portion of the loss. Therefore, we recommend a reasonable time allowance to discuss operational issues.

FAS 157 Revision

Although FAS 157 addresses the use of forced or distressed transactions within an orderly market, it does not address a situation when the entire market is distressed or disorderly. FSP 157-3 attempted to provide further clarification on determining fair value by allowing a company to use its own assumptions to value an asset in an illiquid market, but it continues to require the consideration of nonperformance and liquidity risk premiums reflected in the current dislocated market environment to satisfy the FAS 157 requirement for a current exit price. This requirement effectively assumes that all companies are in a stressed condition and would, therefore, be more likely to transact at those distressed values. In addition, we believe the view of many in the life insurance industry is that, as a result of this change, few companies will be overriding values on securities obtained from pricing services in favor of internal models thereby getting virtually no relief from the disruption in the credit markets. This essentially results in no change to the current practice. A significant issue with existing mark-to-market accounting is that the revised definition of fair value, exit value, in FAS 157 may not be appropriate in all circumstances.

The revision to FAS 157 provided by FSP 157-3 is not sufficient to provide the change necessary to support the use of internal model values when disorderly or distressed markets exist. While we continue to support the use of fair value for certain financial instruments, there is a real world need to calculate those values appropriately when the markets no longer function efficiently. This is clearly the case today in dysfunctional markets for many asset classes, including the market for mortgage-backed securities. The pervasive belief in the life insurance industry is that departing from observable price inputs is only permitted in rare circumstances. For example, the only purchasers of non-agency mortgage-backed securities in today’s market are hedge funds, vulture funds and certain mutual funds. Because it is a strong buyers market, they are able to command sufficient pricing power to achieve risk-adjusted yields in the 20+% level. Insurance companies and other solvent sellers of these types of securities rarely sell into this market. In fact, very often these companies may list their securities at reasonable prices and no orders are placed. To us, this is a dysfunctional market and should not be the primary source of valuations. To the external auditors, though, this is the new definition of the market participant and the exit value notion of FAS 157 requires consideration of their assumptions and transaction prices. We do not believe that this was the spirit of FAS 157; however, it is has become the current interpretation. Unfortunately, the recent efforts of the SEC and the FASB did not make meaningful progress in addressing the world-wide issues with the accounting for fair value. We recommend that the FASB issue a revision to FAS 157 that clearly defines disorderly or distressed markets and provides for the use of internal intrinsic value models in these limited circumstances. This can be facilitated by the use of either a separate category (or level) within FAS 157 for securities in disorderly or distressed markets or it could be better clarified within the three level model currently within FAS 157.

In addition to the above-detailed short-term recommendations, the ACLI encourages the SEC to conceptually revisit fair value from a long-term perspective in light of what we have learned during the recent credit crisis with respect to the impact that fair value accounting has had on the financial statements of affected entities. An assessment is needed to understand the purpose for fair value not just the interpretations of FAS 157. This analysis should include determining how fair value should be defined and calculated in all market conditions, when it is appropriate to be required, how to ensure that similar assets and liabilities are accounted for consistently on a global basis; and the best presentation of fair value in the financial statements. A balance sheet utilizing liquidation based fair values does not factor in all sources of value created by a company, is not consistent with the going concern assumption and has lead to a self-fulfilling prophecy with the acceleration of bankruptcy of several previously legitimate firms.

I would be happy to discuss the ACLI's recommendations in more detail or address any questions you may have at your convenience.

Sincerely,

Michael Monahan
Director, Accounting Policy