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October 25, 2013

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: *Insurance Contracts (Topic 834)*

Dear Mr. Golden:

The Global Financial Institutions Accounting Committee of the Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to provide comments on the Financial Accounting Standards Board's ("FASB's") proposed Accounting Standards Update "*Insurance Contracts (Topic 834)*" (the "Proposed Update" or the "ED"). We have confined our comments to the scope of the Proposed Update.

We believe that guarantees should continue to be accounted for under the ASC 460 (FIN 45) model – particularly those that are incidental to a larger transaction and recorded as part of the overall fair value transaction price. In addition, financial instruments recorded on the balance sheet at fair value, such as catastrophe bonds, should continue to be accounted for at fair value.

While we support the FASB's effort to resolve diversity in practice, and acknowledge that the notion that similar transactions should be accounted for in the same way regardless of the industry in which the parties operate has some appeal, a single accounting model for transactions that are managed differently or are only incidental to another business transaction, itself recorded at transaction price or fair value, can result in information that is not helpful in understanding a company's business and therefore is less relevant for investors. We believe that the Proposed Update, by scoping in guarantees, catastrophe bonds, and other products that are fundamentally different from insurance, would result in less useful and transparent information for financial statement users.

The remainder of our letter highlights how we believe guarantees - including representations, warranties, and indemnifications - and catastrophe bonds differ from insurance, valuation issues and other concerns we would have in applying the ED's guidance, and clarifications that would be needed if the Board were to scope in guarantees to the ED.

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[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

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Guarantees that Result in an Asset for the Issuer if the Guarantee is Triggered

In an insurance contract, the payment of a claim does not result in a contractual right to full reimbursement of amounts paid or an asset received from the contract-holder (except for salvage, which is not intended to make the insurer whole for claim payments). In many of the guarantees included in the scope of the Proposed Update, however, the guarantor is legally entitled to full reimbursement for amounts paid under the guarantee. We believe that these arrangements are by their nature extensions of credit rather than insurance, and should continue to be accounted for under FIN45.

For example, when a bank issues a standby letter of credit (LOC), a drawdown on the LOC by the beneficiary results in a receivable from the borrower representing the right to full reimbursement. As such, an LOC is more like a loan than insurance. To illustrate the loan-like nature of LOCs, we would point out that they can be intertwined with revolving credit arrangements where the customer's revolver limit is apportioned between cash draw-down ability and LOC capacity. Both portions of the limit are considered commitments to extend credit (or a guarantee once an LOC is issued) prior to funding and loans receivable after funding.

Similarly, with liquidity facilities, and certain representations and warranties provided in, for example, asset transfers, when the obligation is triggered the issuer ends up with the asset on its balance sheet. While this asset may be illiquid or impaired, it often has significant value. In contrast, the payment of a claim in a traditional insurance contract does not result in an asset or receivable, and when it does, the Proposed Update specifically scopes the contract out of the proposed insurance accounting guidance.

That is, ASC 834-10-55-26 f. in the Proposed Update scopes out contracts that take the legal form of insurance but pass all significant insurance risk back to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder to the issuer as a direct result of insured losses – i.e., features that result in the policyholder reimbursing the insurer for claims paid. LOCs, liquidity facilities, and certain reps and warranties, while not in the legal form of insurance, are similar in that the counterparty must pay the issuer back – in the form of cash or by turning over an asset - for incurred claims. As such, LOCs and other guarantees that, if triggered, result in an asset on the issuer's books should be scoped out if it is the Board's intention to have guidance that results in company's accounting for similar contracts in the same way – regardless of legal form.

Liquidity facilities generally provide liquidity to a counterparty. Liquidity, which is a financial risk, is not the same as credit enhancement or default risk. Liquidity facilities are often hedged by CDS contracts or other financial instruments. Therefore, liquidity facilities, which have financial characteristics and risks, should be accounted for at fair value. Accounting for them as insurance would not be appropriate and would not reflect the manner in which they are economically hedged, creating accounting mismatches.

Representations, Warranties, and Indemnifications

Many representations, warranties, and indemnifications are issued as part of a larger transaction – such as the sale of a business - and consideration is not ascribed to these features of the transaction or contract, but rather the consideration is included in the overall transaction price or included in the market price of the asset being sold. While many of these contracts are similar in nature to insurance in that they indemnify a holder or beneficiary for an incurred loss, they are quite different from the *business* of insurance, in which:

- large numbers of policies are issued on similar risks which provides some certainty over future cash flows; many indemnifications and guarantees are unique to a particular sales transaction and do not lend themselves to cash flow modeling or the certainty that comes with a large portfolio of similar risks.

- premiums are collected from policyholders to compensate the insurer for the risks assumed and to provide a profit; companies may not separately be compensated for some representations, warranties, and indemnities provided or may receive a fee from a third party rather than from the insured.

- insurers expect some level of losses for most blocks of business; with many indemnifications and guarantees, no losses are expected.

- as mentioned above, many of the LOCs, liquidity facilities, representations, and warranties that would be scoped into the insurance model under the Proposed Update result in assets or receivables on the insured's books upon trigger of the guarantee obligation. The Proposed Update scopes out insurance contracts containing reimbursement mechanisms that mitigate the transfer of insurance risk in a similar way.

We believe that the scope of the Proposed Update is too broad in that most contracts include some sort of reps and warranties or indemnification provisions; it is not practical to treat all of these provisions as insurance contracts.

In addition, reps and warranties provided, for example, in a securitization or other asset transfer are essentially a guarantee of the transferor's performance. The transferor has an obligation to ensure that the transferred assets conform to the parameters set forth in the deal. The representation is that the transferor has performed the evaluation to ensure that all transferred assets comply. While the Proposed Update scopes out guarantees of the entity's own future performance, the example in ASC 834-10-55-40 under Guarantees of Securitized Financial Assets concludes that these reps and warranties are scoped in as insurance. This seems contradictory. In addition, the ED uses the phrase "future performance," implying that the Board is drawing a distinction between a guarantee of future versus past performance; we believe guarantees of both past and future performance should be scoped out of the ED.

Lastly, product warranties issued by manufacturers are specifically scoped out of the draft standard, as the Board has tentatively concluded that they are guarantees of the seller's own performance (BC 41a.) or closely related to the underlying sale of goods (BC42). We believe many reps and warranties are similar, and do not understand why the underlying nature of the product – non-financial versus financial – should result in a different accounting particularly if the Board wants accounting guidance that is similar across industries.

Catastrophe Bonds for which Quoted Market Prices are Available Should Remain Subject to Fair Value Accounting

The ED applies to catastrophe bonds that provide for reduced payments of principal, interest, or both if a specified event adversely affects the issuer of the bond. Catastrophe bonds are securities specifically designed for investment by investors which are not insurance or reinsurance specialists, and typically have the following distinguishing characteristics:

- they are issued as securities, pursuant to a prospectus or offering memorandum, and subject to government securities regulation;
- they often have a securities identification number (CUSIP or ISIN) and clear through DTC or similar clearing facilities;
- they frequently have a credit rating provided by a nationally recognized credit rating agency;
- they include a risk assessment from an independent risk modeling agency (such as RMS or AIR) based on established industry risk models sufficient to allow for market pricing of the applicable loss probabilities;
- their value is entirely determined by the market, which considers not only repayment risk resulting from the insurance feature, but also the market risk of the collateral purchased with the proceeds of the cat bonds issued by the special purpose vehicle that has entered into the reinsurance contract with the sponsor;
- they are freely traded in active markets for which quoted prices are available on either an exchange or in a dealer market;
- they generally are designed to have a higher attachment point and therefore a lower risk of loss as a result of catastrophe, as compared to traditional reinsurance which may attach at a lower level; and
- they are treated for insurance regulatory purposes as an investment transaction by investors in the capital of the issuer, and not as the writing of insurance or reinsurance.

Under current GAAP, catastrophe bonds with above characteristics are recorded by investors at fair value in their financial statements. As these investors generally are not insurance or reinsurance companies, measurement of purchased catastrophe bond investments at fair value conforms to the accounting treatment of other investments, and creates the most objective financial picture for shareholders and others reviewing such investors' financials. The existence of objective market quotations for catastrophe bonds makes fair value presentation of those financial instruments both technically feasible and most objective. Market quotes distinguish catastrophe bonds from traditional insurance, which involves non-traded contracts negotiated bilaterally between private parties that are not designed for resale in a manner that allows for traded market price discovery; we note that the ED's fulfillment model was developed as an alternative measure for non-market based exposure. Consistent with general GAAP principles to rely on objective market prices for financial instruments where available, we believe it would be less useful and transparent to deviate from that standard for the measurement of catastrophe bonds, particularly with respect to investors which are not otherwise regulated insurance or reinsurance entities. Fair value accounting provides more objective and, therefore, a more reliable value for catastrophe bond investors. At a minimum, we believe that the fair value option should be preserved for these instruments.

State insurance regulators and regulators around the world recognize catastrophe bonds, including those linked to indemnity triggers, as securities instead of insurance contracts and they do not treat investors as being engaged in the business of insurance or subject to insurance regulation. By scoping indemnity catastrophe bonds into the Proposed Update, the Board creates the possibility of confusion about the nature and treatment of these instruments. We believe such a development does not provide a superior measurement of the value of these contracts. Furthermore, it may be adverse for the whole sector as it may deprive sponsors of access to valuable risk transfer capital for hedging global catastrophe risk and deprive investors of access to a diversifying asset class to the extent that regulators follow the accounting treatment in determining whether the investment in a catastrophe bond should be regulated as insurance.

Retention of Specialized Industry Accounting for Certain Catastrophe Bond Investors and Holders

Hedge funds, endowment plans, and pension plans are large investors in catastrophe bonds, and broker-dealers may hold catastrophe bonds as market makers. While the Proposed Update does not change the accounting for assets or liabilities held by pension plans, it is unclear if the guidance in the Proposed Update overrides specialized industry accounting followed by hedge funds, endowment plans, and broker-dealers that specifies fair value accounting for investments. We would oppose such an override, as fair value accounting is most relevant to

- sponsors of pension plans determining the funded status of the plan;
- users of pension plan financial statements;
- funds that compute Net Asset Value (NAV) as a basis for purchases and withdrawals; and
- broker-dealers and other entities that may trade these securities.

In addition, investors in dedicated catastrophe funds which have purchased most catastrophe bonds issued in recent years will continue to account for the equity securities they own in the funds at fair value. Even if indemnity-type cat bonds were scoped into the Proposed Update, the accounting used by these investors would not change.

Other Valuation Issues

Restricting the measurement of guarantees to a discounted cash flow analysis may add unnecessary complexity. Some of the guarantees scoped into the Proposed Update and currently accounted for at fair value are valued using other valuation techniques. For example, LOCs may be largely valued based on the credit spread of the borrower, duration, expected fee streams, and a liquidity adjustment. Discounted cash flow analysis may not be appropriate due to the uncertainty surrounding the timing and amount of draw-downs, if any. In many cases, the bank is not privy to the nature of the underlying contract that would trigger a draw-down by the beneficiary if the bank's customer were to default. Because of their loan-like qualities, companies value LOC's using loan-like models.

Complexity and Cost of the Proposed Insurance Model

Many of our members have extensive and robust systems to account for a variety of contracts at fair value, and may not have insurance operations. The cost of developing new systems to produce a close (because it is based on discounted, probability-weighted cash flows), but less desirable measurement exceeds the benefits, if any. The proposed insurance model is also very complex. The notion that the margin eliminating a day 1 gain should accrete interest and amortize down over the life of the contract may be workable for large blocks of similarly grouped policies, but it is not practical for unique, "one off" contracts. In particular, the requirement to separate changes in the measurement of the guarantee due to changes in discount rates and flow these through OCI is problematic.

While we understand and do not disagree with the insurers' argument that fair value is not a relevant measurement for insurance liabilities that they cannot sell and intend to fulfill, we would still argue that the Board should not consider fair value a less acceptable measurement for any asset or liability if a company's business model or management approach supports it. The current accounting model for guarantees is time-tested and well-understood, while application of the proposed insurance model would not result in an improvement in financial reporting.

Clarifications Needed in the Proposed Update

In addition to the question with respect to the retention of specialized industry accounting for certain catastrophe bond investors and holders, we believe the following clarifications are needed in the Proposed Update:

Scope Exception for Unusual and Non-Recurring Guarantees

ASC 834-10-55-41 scopes out of the Proposed Update guarantees that are both unusual and non-recurring. We anticipate that it will be difficult to conclude that a guarantee is non-recurring in some cases; for example, the guarantee may be the first of its kind for the entity, but it may be hard to conclude that the company will not issue another of its type even if it has no plans at the time to do so. The phrase seems to imply a higher standard than the Board intended, as the example provided in the Basis for Conclusions in BC57c. of a guarantee that would likely be scoped out of the Proposed Update – a seller's indemnification related to the sale of a business or an asset – may occur with some frequency. As such, we believe the Board should eliminate the "non-recurring" criterion, or provide additional guidance to clarify intent.

In addition, we envision situations where a company cannot conclude that a guarantee it has issued is non-recurring, and so would apply the guidance in the Proposed Update, only to subsequently determine, with hindsight, that the guarantee met the scope exception. The Proposed Update should clarify that the "unusual and non-recurring" determination should be made at the time the guarantee is issued, and that a company should not revisit that conclusion unless the guarantee is restructured in a significant way.

Residual Value Guarantees

The table in ASC 834-10-55-40 – Residual Value Guarantees, suggests that an arrangement that guarantees the value of an entity's properly maintained nonfinancial assets (for example, equipment) at a fixed date is insurance. This conclusion seems to conflict with ASC 834-10-55-7, which suggests that the risk of changes in the fair value of a nonfinancial asset that is unrelated to physical condition is a financial variable scoped out of the guidance in the Proposed Update.

Convergence

The original goal of both the FASB and IASB in the insurance project was to develop a converged standard. While the proposals of the Boards contain several important differences, the models are largely similar and reflect many joint decisions. With respect to guarantees, however, the current IASB exposure draft scopes out financial guarantees unless the entity has previously elected to account for these as insurance, in which case the entity can elect to continue to treat the contract as insurance or account for it as a financial instrument; the election is on a contract-by-contract basis. A further move towards convergence would be an added advantage of a FASB scope exception for financial guarantees. As noted above, we believe that recording guarantees as insurance does not increase usefulness or transparency of financial statements, particularly with respect to entities which are not regulated insurance entities.

Disclosures

The new disclosure requirements were drafted with insurance companies in mind but non-insurance institutions will have financial guarantee and other contracts that would be in scope and therefore all of the disclosure requirements would apply to these entities as well. The proposed disclosures are comprehensive and while they may make sense in the context of an insurance company with large portfolios of similar types of contracts, many do not lend themselves unique guarantees. In addition, insurance type disclosures may be confusing to users of non-insurer financial statements.

We hope you find our comments helpful. Should you have any questions or require further information concerning any of the matters discussed in this letter, please do not hesitate to contact Susan McGrath (212-902-1862; susan.mcgrath@gs.com) or the undersigned (212-357-8437; matthew.schroeder@gs.com).

Very truly yours,

Matt Schroeder

Matthew L. Schroeder
Chair
SIFMA Global Financial Institutions Accounting Committee

cc: Susan Cosper, Technical Director, FASB
Mary Kay Scucci, PhD, CPA, Managing Director, SIFMA