PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
400 Campus Dr.
Florham Park NJ 07932
Telephone (973) 236 4000
Facsimile (973) 236 5000
www.pwc.com

June 18, 2007

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

1530-100

LETTER OF COMMENT NO. 76

Re: File Reference No. 1530-100, *Proposed Statement of Financial Accounting Standards Accounting for Financial Guarantee Insurance contracts - an interpretation of FASB Statement No. 60*

Dear Mr. Smith:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB" or the "Board") proposed Statement, *Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60* (the "proposed Statement"). We agree that guidance is needed because there is diversity in practice in the claim cost recognition models currently used by the monoline financial guarantee insurance companies. We agree that such diversity should be addressed in a limited scope project while the FASB separately decides whether to put a broader scope project on its agenda to reconsider the entire insurance contract accounting model.

While we support the need for guidance, we recommend that the proposed Statement be modified as follows:

- The premium revenue recognition guidance should require the premium to be recognized over the life of the borrowing.

  This treatment would be more consistent with existing guidance for financial instruments, insurance contracts, and service contracts, and would better reflect the economics of a financial guarantee transaction. That is, the insurer effectively lends the debt issuer its credit rating to lower the issuer's cost of funds. One Board member described this as the "economic renting" of the financial guarantor's capital structure over the life of the borrowing. Considering that the debt issuer benefits from this arrangement throughout the term of the debt, we

believe the life of the borrowing is the appropriate period over which to recognize the related revenue.

The notion of "economic renting" is similar to a situation in which the insurer purchases the debt of the debt issuer and issues its own debt to the purchaser (the guaranteed party). In that situation, FAS 115 would permit the purchased debt to be accounted for at amortized cost if the intent is to hold the debt until maturity. The issued debt also would be accounted for at amortized cost. Because the default risk of a financial instrument is reflected in the increased interest required for that instrument versus a similar risk-free instrument, the net interest income spread would be recognized using an effective yield method over the life of the two components.

- The measurement of the premium receivable and the revenue recognition basis should consider estimated prepayments.

  We believe that a model under which no consideration is given to estimated prepayments would produce accounting results that are inconsistent with the economics and pricing of financial guarantee transactions, which reflect consideration of estimated prepayments. It also would be inconsistent with accounting literature in other areas when information exists to reliably assess the likelihood of prepayment. For example, FAS 91, paragraphs 19 and 58, permits consideration of estimates of future principal payments in calculating an effective yield when the enterprise holds a large number of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated. Many of the installment premium financial guarantee contracts relate to borrowings backed by pools of investments for which we believe prepayments can be reliably estimated.

  Further, ignoring prepayment expectations in the premium receivable and revenue recognition model seems inconsistent with the proposed claim recognition model, under which expectations of future cash flows are considered. It is also unclear how an asset whose value is determined based on contractual payments that are not probable of occurring would meet the Concept Statement definition of an asset, which is "a probable future economic benefit obtained or controlled by" the insurer.

- The interplay between unearned premium revenue and the claim liability should be clarified, as more fully described in our response to Issue 13. In addition, the Board should consider whether the installment premiums receivable and deferred acquisition costs should be included in the claim liability analysis.

- To measure the claim liability, the proposed Statement should call for the issuer to use a discount rate determined as of the inception of the contract, rather than as of the date the claim liability is first needed. We believe the discount rate at

PRICEWATERHOUSECOOPERS

the inception of the contract is more consistent with the Board's desire to eliminate from the measurement the effect of general changes in the interest rate environment.

Our responses to the specific issues on which the Board is seeking comments are included in the Appendix to this letter.

If you have any questions about our comments, please contact Donald Doran (973-802-4175) or Mary Saslow (860-693-4407).

Sincerely,

PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS

APPENDIX

Proposed Statement of Financial Accounting Standards
Accounting for Financial Guarantee Insurance Contracts – an Interpretation of FASB Statement No. 60

Scope

Issue 1: The scope of this proposed Statement defines a financial guarantee insurance contract as a contract issued by insurance enterprises that provides protection to the holder of a financial obligation from a financial loss in the event of a default. The event of a default (insured event) refers to nonpayment (when due) of insured contractual payments by the issuer of the insured financial obligation. Do you agree with the definition used to identify a financial guarantee insurance contract subject to the provisions of this proposed Statement? If not, why not?

Response: We believe the definition of financial guarantee insurance contracts provided in paragraph 3 is consistent with the FAS 149 definition of non-derivative credit instruments, which are treated as insurance in practice. However, paragraph 4 could be interpreted as limiting the scope of the document to a subset of such financial guarantee insurance contracts, i.e., those for which "the insurance enterprise does not have the ability to negotiate the claim amount prior to payment (that is, the claim amount must be paid as submitted)." We recommend the Board clarify whether that phrase is intended to be an additional criterion (i.e., beyond the definition in paragraph 3) for a contract to be considered within the scope of the proposed Statement, or just an observation on how financial guarantee contracts generally operate. If it is intended to be an additional criterion, we recommend the Board provide its rationale for this, giving consideration to the fact that claims under other types of insurance are commonly subject to negotiation.

In addition, we recommend the Board clarify why mortgage guaranty, credit insurance contracts on trade receivables, and other "similar" insurance contracts would be excluded from the scope, despite the fact that they appear to meet the definition in paragraph 3 of financial guarantee insurance contracts. The guidance should also define mortgage guaranty, credit insurance on trade receivables, and "similar contracts" in a manner that would clearly distinguish them from "financial guarantee insurance contracts."

Issue 2: This proposed Statement would apply to financial guarantee insurance (and reinsurance) contracts issued by insurance enterprises included within the scope of Statement 60. Do you agree with the scope of the proposed Statement? If not, why

not? Should the scope include other insurance contracts that are similar to financial guarantee insurance contracts issued by insurance enterprises? Should the scope include all financial guarantee contracts (that is, those issued by insurance and noninsurance enterprises)?

Response: We believe that the scope sentence is circular and unclear and suggest that it be revised. Paragraph 2 notes that the proposed Statement applies to contracts issued by insurance enterprises included in the scope of paragraph 6 of FAS 60, yet the proposed revisions to paragraph 6 state that it applies to insurance enterprises that issue financial guarantee contracts included in the scope of the new Statement. We recommend deleting the phrase in paragraph 2, "included within the scope of paragraph 6 of Statement 60." Paragraph 2 would also require revision if the Board intends that paragraph 4 serve as an additional criterion that must be met for a financial guarantee insurance contract to be included in the scope of the proposed Statement. In that case, the proposed Statement would not apply to all financial guarantee insurance contracts; only to those that also meet the more restrictive paragraph 4 criterion.

We are concerned that the accounting for substantially similar financial guarantee contracts issued by insurance and noninsurance enterprises will be accounted for differently. We believe that it is important to the continued focus on reducing complexity that similar accounting be required for similar transactions. However, as the proposed Statement will be an interpretation of FAS 60, which is applicable only to insurance enterprises, it would seem inappropriate to amend the scope of FAS 60 at this time.

Issue 3: The scope of this proposed Statement would not apply to a financial guarantee insurance contract that is a derivative instrument included within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Should more guidance be provided regarding paragraph 10(d) of Statement 133 and how to apply that paragraph?

Response: We understand that there may be practice issues relating to the application of paragraph 10(d) of FAS 133. However, given that this project is meant to be a limited scope project addressing the accounting model for financial guarantee contracts that are outside the scope of FAS 133, we believe that the proposed interpretation is not the appropriate document for addressing FAS 133 interpretation issues. We suggest that any such interpretive issues be addressed by the FASB staff through a separate DIG process.

Unearned Premium Revenue (Paragraphs 7–11)

Issue 4: This proposed Statement would require that an insurance enterprise recognize a liability for unearned premium revenue at inception of a financial guarantee insurance contract. Further, a premium receivable (asset) would be recognized at inception of the financial guarantee insurance contract for which the premiums are received in installments (since each installment premium is not considered a renewal premium but merely a form of financing). Do you agree? If not, why not?

Response: We believe the statement that installment premiums are not considered renewal premiums but rather a form of financing is an over simplification. Many times installment premiums are used because the amount of insurance needed in a given period is not fixed, such as in securitization of assets with prepayment options. The proposed Statement should clarify that the present value of installment premiums should be recognized at inception in those situations where such contracts are noncancellable. We believe the installment premiums to be recognized should be based on the premiums expected to be received rather than the contractual cash flows, as further described in Issue 5.

Issue 5: Under this proposed Statement, the measurement of the initial unearned premium revenue (liability) would be the present value of the contractual premium due pursuant to the terms of the financial guarantee insurance contract. Further, for premiums received in installments, the initial measurement of the unearned premium revenue (liability) would be based on the present value of the contractual premium receivable (asset). Do you agree? If not, why not?

Response: As noted in our cover letter, using contractual terms rather than estimated prepayments for contracts insuring obligations backed by pools of investments consisting of a large number of similar loans is inconsistent with the economics of the arrangement and with the pricing of financial guarantee transactions, both of which consider estimated prepayments.

Issue 6: This proposed Statement would require that the present value of the premium receivable (asset) be determined using a discount rate that reflects the policyholder's credit standing at the inception of the contract. The discount rate would be accreted on the premium receivable (asset) through investment income over the period of the contract in accordance with APB Opinion No. 21, *Interest on Receivables and Payables*. Do you agree? If not, why not?

Response: We agree that the credit characteristics of the premium receivable are related to the party responsible for making the premium payment, and thus believe

the discount rate should reflect the credit characteristics of the entity that has the payment obligation to the insurer. We observe that the entity responsible for making the premium payment is not always the policyholder. Also, as noted previously, we do not believe it is appropriate to include in the asset measurement future cash flows that are not probable of occurring due to expected prepayments.

Issue 7: This proposed Statement does not provide specific guidance related to changes in contractual premiums, such as changes due to interest rates on a floating-rate insured financial obligation or partial prepayments of an insured financial obligation. How often are floating-rate financial obligations insured by insurance enterprises within the scope of this proposed Statement? How often do partial prepayments of an insured financial obligation occur? Do you believe the Board should provide additional guidance for these changes in contractual premiums?

Response: Guarantees of floating rate obligations are fairly common in both municipal and structured finance portfolios. In the municipal portfolio, it is common for a municipality to issue floating rate bonds and separately enter into an interest rate swap with a financial institution to effectively convert the obligations to fixed rate debt. The floating rate instruments and the interest rate swap are guaranteed by the financial guarantee insurer. Floating rate obligations are also common for hospital revenue backed bonds. In the structured finance portfolio, the floating rate obligations tend to be on asset-backed obligations.

Partial prepayments within an underlying asset pool are very common for asset-backed and mortgage-backed security transactions, even on floating rate obligations.

As noted in our response to Issue 5, we support using estimated rather than contractual cash flows in situations where such amounts can be reasonably estimated. As noted in our response to Issue 8, we also support using an alternative revenue recognition model that involves using estimated rather than contractual payments and periodically updating those estimates. However, in the event that the Board retains the proposed recognition model, given the prevalence of variable rate and prepayable instruments underlying financial guarantee contracts, we believe the Board should provide additional guidance on how to account for changes in contractual premiums. We believe a catch-up or retrospective approach would be more appropriate than a prospective approach.

The guidance is unclear about how to relieve the installment receivable and unearned premium for future contractual amounts in the event a prepayment occurs. If the Board retains the use of the contractual cash flows, as proposed, we do not believe such adjustments should be recorded in the income statement. We believe such amounts should be offset, with only the write-off of the accrued income on the

installment receivable recorded in the income statement. We also note that the write-off of accrued interest further illustrates why the consideration of contractual cash flows instead of expected cash flows would not capture the true underlying economics.

Premium Revenue Recognition (Paragraphs 12–17)

Issue 8: This proposed Statement would require that an insurance enterprise recognize a premium from a financial guarantee insurance contract as revenue over the period of the contract in proportion to the insured contractual payments made by the issuer of the insured financial obligation. The premium revenue for each reporting period would be determined based on the ratio of (a) the insured contractual payments made on the insured financial obligation during the reporting period to (b) the total of all insured contractual payments to be made on the insured financial obligation over the period of the contract. During its deliberations, the Board considered measuring at fair value a financial guarantee insurance contract, noting that a fair value measurement would include changes caused by the passage of time. However, the Board did not pursue a fair value measurement because it is unwilling at this time to change to the fair value measurement attribute within the insurance accounting model for only one type of insurance contract. Do you agree with the proposed premium revenue recognition approach? If not, why not? Also, if not, what should be the appropriate determinant of revenue recognition?

Response: As discussed in our cover letter, we disagree with the proposed revenue recognition approach.

We believe the premium should be recognized over the expected life of the guaranteed obligation using an effective yield method. Under that method, the premium would be recognized as revenue over the expected life of the contract at a constant rate applied to the expected principal outstanding on the debt obligation. Changes in estimate due to changes in actual or projected prepayments would result in revisions to the calculation.

Authoritative accounting guidance provides three methods for the recognition of changes in prepayment assumptions under the effective yield model, as described in paragraph 97 of Concepts Statement 6: (1) the prospective approach (2) the retrospective approach - provided in FAS 91, and (3) the catch-up approach (also used in IFRS 9). The prospective method results in the recognition of changes from expectation over the remaining period, thus deferring gains and losses to future periods. The retrospective method requires that the effective rate be adjusted to reflect historic and revised expected prepayment rates, with the results of the change in the effective rate being recognized currently in earnings and the new effect rate

utilized for future amortization. We believe these methods would not fully reflect the economics of the transaction.

The cumulative catch-up method provides that once the effective rate is determined at inception, it remains fixed and any change in actual experience from this expectation is recognized immediately in earnings as a gain or loss. Amortization continues at the effective rate determined at inception. In our view, the cumulative catch-up method most accurately reflects the pricing and economics of a financial guarantee transaction. An added benefit of the cumulative catch-up method is that the data required to perform the calculation (expected yield at inception and future estimated cash flows) is relatively easy to capture as compared to the more cumbersome retrospective method (which requires historic cash flow data).

If the Board decides to provide guidance purely in the context of the FAS 60 model, rather than the model proposed above, we offer the following comments:

We do not believe that the revenue recognition model in the proposed Statement is consistent with the FAS 60 short duration model. The FAS 60 short duration revenue recognition model for single event covers, such as fire, hurricane, and the like, recognizes the revenue ratably over the period of coverage in proportion to the amount of insurance protection provided. We believe the FAS 60 model differs from the model in the proposed Statement, which is a release from risk model. Applying the current FAS 60 short duration revenue recognition model to financial guarantee contracts would result in recognition of premium revenue over the expected term of the debt (and in proportion to the amount of debt outstanding).

The existing long duration model in FAS 60 is similar to the short duration model in that revenue is recognized over the life of the contract, i.e., over the period the insurer is exposed to risk. In the existing long-duration insurance models, including both FAS 60 and FAS 97, revenue is recognized over the life of the insurance contract, even though the release from risk does not occur until the end of the policy (upon death of the insured). For example, FAS 97 provides guidance for FAS 60 limited pay contracts. The proposed model essentially considers all financial guarantee insurance contracts to have a single up-front premium payment, either in cash or in the form of an interest bearing receivable. The limited pay model defers all upfront premiums in excess of capitalized acquisition costs at contract inception but then requires an amortization of the deferred revenue over the life of the block of insurance contracts.

Both the effective yield model we propose and the existing FAS 60 models recognize the service provided by the financial guarantor over the coverage period and reflect the reduction in risk due to the passage of time. The proposed approach, in contrast,

uses contractual payments on the insured obligation as the sole determinant of the reduction in risk. Accordingly, we believe the proposed approach is not consistent with the economics of the transaction or existing literature.

Issue 9: The Board concluded that insured contractual payments of the insured financial obligation are the most appropriate measure of exposure in a financial guarantee insurance contract. Do you agree? If not, why not? Also, if not, what would be a more appropriate measure of exposure and why?

Response: As noted in our response to Issue 8, we disagree with the proposed revenue recognition methodology, and, as noted in Issue 5, we disagree with the use of contractual rather than expected premium payments.

Issue 10: Under the guidance in this proposed Statement, premium revenue would not be recognized for an insured zero coupon bond until the insured contractual payments are made at maturity. Do you agree that the proposed premium revenue recognition approach sufficiently incorporates the passage of time? Why or why not? How are these insured financial obligations affected by the passage of time (that is, how does the premium charged for the financial guarantee insurance contract change over time and what is the ability to subsequently price the contract)? Please provide examples.

Response: We do not believe that the premium revenue recognition model in the proposed Statement appropriately captures the reduction of risk due to the passage of time.

We believe the concept that risk is reduced over the life of the contract is best illustrated by the differences in pricing between contracts of varying length. It is our understanding that the price of a financial guarantee contract varies depending on the expected term of the guaranteed debt. That is, the premium for a contract providing a guarantee on an expected five year term debt instrument would reflect the price for a five year exposure period, while the premium charged for a guarantee on an expected ten year term debt instrument would be larger, reflecting the additional exposure period.

Issue 11: The Board concluded that the contractual period covered by the insured financial obligation should be used in determining the period over which premium revenue should be recognized. Do you agree? If not, why not? When prepayment information is available, should this information be used to adjust the contract term when a homogenous pool of underlying contracts exists and is measurable? If so, please provide examples of these arrangements and a description of how reliable prepayment estimates are.

Response: We believe prepayment information is considered in the negotiation of the price and therefore should be reflected in the accounting. Paragraph B14 seems contradictory in that it implies that prepayment is more difficult to predict than expected future defaults, which the proposed Statement requires the issuer to consider. As noted in our cover letter, many installment premium contracts are on borrowings backed by pools of investments for which we believe prepayments can be reliably estimated.

Issue 12: In instances where the issuer of an insured financial obligation that had a nonrefundable premium retires an insured financial obligation before its maturity and replaces it with a new financial obligation, this proposed Statement would require that any unearned premium revenue (liability) related to that contract and associated deferred acquisition costs be immediately recognized as premium revenue and expense, respectively. Further, if the insurance enterprise insures the new financial obligation, the insurance enterprise would record a premium on the new financial obligation that is commensurate with the premium it would charge to insure a similar financial obligation in a separate (standalone) transaction. If that premium differs from the premium actually charged, the difference would be recognized in current income. Do you agree? If not, why not?

Response: We agree with the proposed accounting assuming that the existing financial guarantee insurance contract between the insurer and insured has been extinguished. We recommend that this point be clarified in the final Statement to distinguish the accounting from situations where the original financial guarantee insurance contract obligates the financial guarantor to provide coverage during any refinancing term (i.e., where the financial guarantee insurance contract has not been extinguished and thus immediate gain recognition would not be appropriate).

Claim Liability (Paragraphs 18–24)

Issue 13: This proposed Statement would require that an insurance enterprise recognize a claim liability on a financial guarantee insurance contract when the insurance enterprise expects that a claim loss will exceed the unearned premium revenue (liability) for that contract based on expected cash flows rather than when a default (insured event) occurs. Do you agree? If not, why not? Does this provide an appropriate point of recognition for a claim liability related to a financial guarantee insurance contract?

Response: We agree that a claim liability should be recorded based on expected cash flows rather than upon an event of default. However, we believe that certain of

the mechanics involved in recording the claim liability need to be clarified, and potentially revised, as follows:

1) Clarify whether the claim liability to be recorded is equal to the present value of expected cash flows, or the present value of expected future cash flows *minus* the remaining unearned premium liability. The Statement should clarify whether, when a claim liability is recognized, the unearned premium liability (the stand ready obligation) ceases to exist, or continues to be amortized in the future (with an offsetting increase in the claim liability).

2) Clarify why any previously deferred acquisition costs for an individual contract are required to be expensed at the point in time when expected losses exceed the unearned premium revenue liability. If the model is trying to impose a contract by contract premium deficiency test, the paragraph 19 calculation of needed claim liability should compare expected claim costs to the unearned premium revenue liability *minus any remaining DAC.*

3) Explain why an individual level premium deficiency test is appropriate, as it represents a deviation from the FAS 60 guidance. In addition, the revision to paragraph 6 of FAS 60 described in C1(a) of the proposed Statement should say "Except for the sections on premium revenue and claim cost recognition (paragraphs 9-10 and 13-18) , and except for the premium deficiency guidance in paragraphs 32 - 37, this Statement . . ."

   If it was not the intent of the Board to amend the FAS 60 premium deficiency test, which is done for a group of policies, it is unclear why DAC for an individual contract would be required to be written off when expected costs for an individual policy are expected to exceed the unearned premium revenue liability.

4) Clarify the impact on the claim liability calculation of any remaining installment premium receivable and unearned premium liability. That is, it appears that either (a) the claim liability calculation should take into consideration the potential that any remaining installment premium or portion thereof will not be paid, or (b) the premium receivable should be assessed for recoverability consistent with the assumptions used in the claim liability calculation.

5) Clarify whether the placement of an obligation on a surveillance list is the triggering event for recognition of a claim liability or merely one of the indicators that should be considered in estimating expected cash flows, as described in further detail in Issue 15 below.

Issue 14: This proposed Statement would require that an insurance enterprise measure a claim liability based on the present value of expected cash flows discounted using a risk-adjusted rate at the time of the initial recognition of the claim liability. For purposes of this proposed Statement, that risk-adjusted rate shall be based on the risk-free rate, adjusted for the credit standing of the insurance enterprise. The discount rate would be updated only when a default occurs. Do you agree? If not, why not?

Response: We agree that the discount rate should be based on the credit standing of the insurer and not changed periodically. However, consistent with our economic view of the transaction, the discount rate on a debt obligation in the amortized cost model is based on the rate at the inception of the debt. Theoretically, the expected cash flows calculation is performed from day one forward and would produce some level of expected claims losses even at contract inception (albeit less than the unearned premium due to the risk margin). The date the expected claims losses exceed the recognition threshold would not be the appropriate date to lock in the interest rate.

We believe the discount rate should be based on the credit standing of the insurer at the *inception* of the financial guarantee insurance contract, and not on the rate on the day the present value of future cash flows exceeds the unearned premium revenue liability. Using the discount rate at the inception of the contract is more consistent with the Board's desire to prevent changes in the interest rate environment from affecting the results of operations.

If a change is not made to the Statement as proposed, it is possible that a claim liability would not be needed at one date (using the interest rate at that date) but could be required, even without a change in expected cash flows, at a subsequent date due solely to a change in the interest rate environment, which is contrary to the Board's intention. Similarly, we do not agree that the rate should be reset at the event of default. The default does not change the nature of the obligation to the policyholder.

Issue 15: This proposed Statement would require that in measuring the expected cash flows of the claim liability, the expected cash flows be developed using the insurance enterprise's own assumptions about the likelihood of all possible outcomes based on all information available to the insurance enterprise and those assumptions be consistent with the surveillance list maintained by the insurance enterprise. Do you believe that the surveillance list maintained by the insurance enterprise should affect the measurement of the claim liability? If not, why not and what alternative approach could be used? Do all insurance enterprises maintain a surveillance list and, if so, is the Board's understanding of the maintained surveillance list (as described in

paragraph B21) accurate? Do you believe the Board should provide additional guidance about the surveillance list and what it contains? Can (or should) insurance enterprises follow the claim liability approach in this proposed Statement for financial guarantee insurance contracts not included on the surveillance list?

Response: We believe that a calculation of future cash flows should utilize an entity's own assumptions, determined using a robust process that considers all available, *pertinent information obtained internally or externally and the likelihood of all possible* outcomes. The Statement should clarify that the placement of an obligation on a surveillance list (or the movement between categories) is one of the key indicators that should be considered in estimating expected cash flows but is not necessarily the only triggering event for recognition of a claim liability (or a revision to a claim liability estimate). This is an important distinction given that there does not appear to be a common definition of a surveillance list, commonly defined surveillance categories, or common surveillance procedures.

For example, we assume that a company that does not monitor its surveillance list adequately should nonetheless be required to have a claim liability if there is information reasonably available that indicates the need for such a liability. We do, however, agree with the requirement to have contract specific information for the establishment of a claim liability in excess of the unearned premium liability as opposed to establishing a general portfolio reserve, as we believe the unearned premium liability in effect represents that general obligation.

Disclosures (Paragraphs 25 and 26)

Issue 16: This proposed Statement would require that specific disclosures be provided about (a) premium revenue recognition accelerated due to early retirement of the insured financial obligation, (b) financial guarantee insurance contracts for which premiums are received in installments, (c) the future contractual runoff of the unearned premium revenue (liability), and (d) the surveillance list used to recognize and measure claim liabilities. Do you agree? If not, why not? Do you believe these disclosures will assist financial statement users in better understanding the financial information for insurance enterprises that issue financial guarantee insurance contracts?

Response: We generally agree that these disclosure requirements will increase transparency and understandability of the accounting. We recommend that clarification be provided for disclosure (a), above, that early retirement of the insured obligation includes partial prepayments or alternatively that partial prepayments be disclosed separately from lump sum prepayments. As discussed throughout this *response letter, we believe expected premiums are more relevant than contractual*

premiums for financial measurement purposes and therefore recommend that the disclosures identified as (c), above, refer instead to the runoff of *expected* unearned premium revenue. As discussed in Issue 15, the Statement should clarify that the placement of an obligation on a surveillance list (or the movement between categories) is a key indicator to be considered in estimating expected cash flows but Is not necessarily the only triggering event for recognition of a claim liability (or a revision to a claim liability estimate). However, the description of disclosure (d), "surveillance list used to **recognize** and **measure** claim liabilities. . ." seems to imply that the surveillance list is indeed the triggering event. If that is the Board's intent, we recommend that this language be revised.

Effective Date and Transition (Paragraphs 27–30)

Issue 17: The final Statement is expected to be issued in the third quarter of 2007. The Board concluded that this proposed Statement should be effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted. Do you agree with the Board's conclusions on the effective date? If not, what would be a reasonable period of time for implementation for applying the provisions of this proposed Statement? Also, if not, please provide a description of the process changes necessary to implement this proposed Statement that would require additional time.

Response: We recommend that the Board delay the effective date by one year from the date included in the proposed Statement. It is our understanding that any change in the premium or claim recognition approach currently being applied would necessitate significant systems and process changes. We also understand that there is insufficient data by contract in the accounting records to be able to adopt this standard by the first quarter of 2008. Information including contractual cash flows and discount rates will need to be compiled in order to set up installment receivables and the associated accretion of income, as well as for calculating revenue recognition. Other standards affecting the industry with the same effective date, such as FAS 157, FAS 159, and the new derivatives disclosures guidance, may also require significant implementation efforts.

Issue 18: This proposed Statement would require that an insurance enterprise recognize the cumulative effect of initially applying this proposed Statement as an adjustment to the opening balance of retained earnings for that fiscal year. Retrospective application is not permitted. Do you agree with not permitting retrospective application? If not, do you believe that retrospective application is possible and that sufficient information exists so that hindsight would not be used or required in reporting prior-period balances?

Response: We agree that retrospective application should not be permitted.

General: This proposed Statement uses a new format in an effort to improve understandability of FASB documents. Do you believe the new format increases the understandability of this proposed Statement? What changes do you like? What changes do you not like? What additional improvements could be made to increase the understandability?

Response: The new format generally improves the understandability of the proposed standard. We believe that by including examples and information previously included in the basis for conclusions in the main text of the standard, the reader is provided with improved perspective in a single location. In addition, enclosing the examples in boxes allows the reader to easily differentiate between the guidance and the examples, allowing the reader to choose to continue with the text, or to focus on the example.

Although the format improves understandability, we recommend the following.

1) In the table of contents, the reader can easily identify that "Standards of Financial Accounting and Reporting" is a major topic heading, that "Claim Liability" is a subsection of that major topic heading and that "Measurement" is a subsection of "Claim Liability". However, in the text, these distinctions are demonstrated only by the slightest change in text size and italics. It is unclear which sections are subsections and which represent a new first-level heading or topic heading. We suggest further differentiation of the subsections. This may be accomplished through the use of underlining the subsections titles such as "Recognition" and "Measurement".

2) On page 11 of Appendix A, the bold heading "Example—Schedule of Insured Financial Obligations Included on the Surveillance List" is not immediately followed by an example. We recommend repositioning the heading so that it appears immediately before the third last sentence in paragraph A3. In addition, the aforementioned heading and chart should also be boxed in for consistency as the rest of the examples in the draft appear in a boxed format. This will ensure that the reader is immediately able to distinguish between guidance and examples.