Subject: Comments of CEJ and CFA on the ACLI Proposal to Change Accounting Rules for Deferred Tax Assets
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Mr. Tittle,

This e-mail recaps our comments made during the recent SAP working group call on the proposal to change accounting rules for deferred tax assets.

The Center for Economic Justice and the Consumer Federation of America strongly oppose the proposed changes to the accounting treatment for deferred tax assets (DTA).

Statutory accounting is different from tax accounting for a reason. Statutory accounting is designed to be more conservative to ensure that insurer has sufficient liquid assets and resources to weather unexpected economic conditions and events to protect policyholders. Contrary to comments of the ACLI, statutory accounting is not designed to reflect the economic condition of the insurer to investors.

The effect of the ACLI proposal is to include a greater amount of non-liquid assets in surplus and to create risky and unreliable projections about DTA. Contrary to the ACLI claims, again, the proposed change harms consumers by reducing the amount of true liquid resources available to the insurer. By counting more DTA in surplus, less cash is needed to meet regulatory capital standards.

The ACLI argues that DTA are due to timing differences between statutory and tax accounting for certain expenses. True. The ACLI argues that the differences reverse over time. Also true. But what ACLI fails to point out is that over time aggregate DTA maintain or grow because the insurer is continually adding new DTA while retiring old DTA. While the creation of DTA is due to accounting timing differences, the fact remains that DTA continue and are not available as cash for the insurer.

The proposal to increase DTA from 10 to 15% of surplus means that cash-type assets will become a smaller portion of surplus.

The proposal to extend the projection period to 3 years is particularly ill-advised. While an insurer could reasonably estimate DTA a year ahead in a stable environment and market -- no great changes in expenses or net income -- a reasonable projection can not be made during an unusual economic period and clearly cannot be made reasonably three years into the future. And it is specifically the purpose of surplus to provide the insurer with a cushion during unexpected times.

Consider the following. An insurer makes a large profit in year 1, in part, because of significant increases in sales. Substantial DTA are generated because the insurer has more income on a tax basis than on a statutory basis. But in year 2, there is a financial crisis resulting in lower sales and net losses. The DTA disappears. It was a “good” asset as it offset the negative DTA of year 2, but it was never available to the insurer to protect policyholders.

We are particularly concerned that the ACLI proposal reflects an effort to carry the massive 2008 losses forward via DTA for two years more than currently allowed. This is a terrible reason to change accounting rules.

There is no basis for ACLI claims that the proposed change will more accurately reflect the true financial condition of the company -- it certainly would reflect a less accurate condition of the meaningful surplus available to the company.

There is no evidence that the current treatment of DTA reflects over-conservatism, as claimed by ACLI and certainly no basis for the claim that the current rule harms consumers. If the current rule is overly conservative, why did a number of insurers experience financial stress in the past year, including some seeking federal assistance and many seeking capital and surplus relief?

Regulators cannot rely on the unsubstantiated assertions by ACLI that fill its presentation.

The ACLI proposal, if enacted, would increase the speed of decline for financially stressed insurers. As an insurer moves into financial distress, the insurer would lose the DTA with a resulting reduction in surplus – thereby speeding the insurer's decline in financial condition.

The limitation on DTA for distressed insurers is based on the fact that the DTA are not useful assets – not useful for protecting consumers and, therefore, not counted. Why then should they be counted if the company is not in financial peril? Why should the accounting for an asset change because of the financial condition of the company?

The proposed change is profoundly anti-consumer and should be rejected. CEJ and CFA are stunned that the NAIC continues to spend time considering these give-aways to insurers while not addressing the problems faced by consumers in the aftermath of the financial market crisis and recession from insurers' use of consumer credit information.

Thank you for your consideration,

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Bob Hunter, CFA