

August 31, 2010

Mr. Russell G. Golden  
Technical Director  
Financial Accounting Standards Board  
Norwalk, CT 06856-5116

**Re: File Reference No. 1810-100, Proposed Accounting Standards Update,  
“Accounting for Financial Instruments (Topic 825) and Revisions to the  
Accounting for Derivative Instruments and Hedging Activities (Topic 815)”**

Dear Mr. Golden:

The Financial Instruments Reporting and Convergence Alliance (“FIRCA”) is a coalition of several trade organizations, American Council of Life Insurers, Commercial Real Estate Finance Council, Group of North American Insurance Enterprises, Mortgage Bankers Association, Property Casualty Insurance Association of America, The Financial Services Roundtable, The Real Estate Roundtable, and The U.S. Chamber of Commerce, representing all sectors of the economy and areas of the financial services arena.<sup>1</sup> FIRCA recognizes that accurate and transparent financial reporting is a cornerstone of our capital markets in the United States and globally. FIRCA welcomes the opportunity to comment on the Financial Accounting Standards Board (“FASB” or “Board”) exposure draft on “Accounting for Financial Instruments (Topic 825) and Revisions to the Accounting for Derivative Instruments and Hedging Activities (Topic 815)” (“Proposal”). As requested, FIRCA is submitting this comment letter by September 1, 2010 in order to participate in the Board’s public roundtables in October 2010.

FIRCA supports the Board’s overarching objective to simplify and improve financial reporting for financial instruments. FIRCA recognizes the significance of this project. But, because of its significance, it is important that the project be done

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<sup>1</sup> While we all agree with the substantive points of this letter, association members may have differing opinions on the finer points, which will be expressed in either their individual association or company responses.

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right. We urge the FASB to reconsider the substance of the Proposal in accordance with the principles and comments we have outlined below.

Further, while we would like to reiterate our support for the necessity of the FASB and the International Accounting Standards Board (“IASB”) working together on completing their major projects to improve U.S. Generally Accepted Accounting Principles (“GAAP”) and International Financial Reporting Standards (“IFRS”) and achieving their convergence,<sup>2</sup> and we appreciate that the FASB and IASB recently modified their strategy for doing so, nonetheless, it is likewise important to recognize that the problems intended to be addressed by this modified strategy are only exacerbated when the IASB and FASB take separate approaches to the same issue and expose for public comment guidance that substantially differs. This is the case with this Proposal by the Board and the IASB’s corresponding Exposure Drafts on *Financial Instruments: Amortized Cost and Impairment* and *Financial Liabilities: Classification and Measurement, Fair Value Option*. FIRCA encourages the FASB and IASB to resolve their differences, in accordance with the principles and comments that we have provided below, before re-exposing their proposals for public comment.

#### *Overview*

FIRCA supports the premise that accounting and reporting for financial instruments should reflect both a reporting entity’s strategy for the instruments and its business model. The financial statements should help explain the business and its operations on a going concern basis. In order to do so, the classification, measurement, and disclosures for financial instruments need to reflect the entity’s purpose for holding these assets and liabilities and its strategy for managing them. A business should not be presumed to be in a liquidation mode. It is this perspective that forms FIRCA’s views on the Board’s Proposal. Unfortunately, while articulating this overall premise, the Proposal, nonetheless, equivocates on its implementation. The remainder of this letter provides FIRCA’s views on accounting and reporting related to the following areas of the Board’s Proposal: financial assets, impairments, financial liabilities, and derivatives and hedging.

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<sup>2</sup>For example, see the June 4, 2010 letter from FIRCA to Mr. Robert Herz, Chairman of the FASB, and Sir David Tweedie, Chairman of the IASB.

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*Financial Assets*

Consistent with the premise that accounting and reporting for financial instruments should reflect a reporting entity's strategy for the instruments and its business model, FIRCA supports the following principles for classification and measurement of financial assets, which diverge from the Board's Proposal in a number of important areas including the availability of amortized cost as a measurement attribute for financial assets:

- Classification and measurement of financial instruments should be at fair value, including fair value with periodic changes in fair value recognized in other comprehensive income (OCI), or amortized cost based on the underlying purpose of holding or issuing financial instruments, which includes both the reporting entity's strategy for the financial assets as well as its business model.
- Financial instruments held for trading purposes, including derivatives not associated with cash flow hedges, should be measured at fair value with periodic changes recognized in net income.
- Financial instruments (including loans and receivables) that are managed on a contractual yield basis should be measured at fair value with periodic fair value changes reflected in OCI or amortized cost consistent with the reporting entity's business model.
- The criteria for reporting at fair value (with periodic fair value changes reflected in OCI) or amortized cost should not preclude the ability to carry out prudent portfolio management or put at risk the future use of fair value with periodic changes in fair value reflected in OCI or amortized cost measurement bases. Reclassifications should be required if management's business strategy changes.
- Hybrid securities with embedded derivatives requiring bifurcation should not automatically be measured at fair value, with changes in fair value reflected in net income. Rather, embedded derivatives should be bifurcated and reported separately using existing GAAP guidance and the remaining host should be measured considering the reporting entity's business strategy for the instrument

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(i.e., hold for collection or payment of cash flows or current settlement) and its business model.

Further, requiring reconciliations from amortized cost to fair value on the face of the statement of financial position for financial instruments where the entity's business strategy is to hold them for collection of contractual cash flows is inconsistent with the overarching premise that the accounting and reporting for financial instruments should reflect an entity's business model. The proposed reconciliations also add unnecessary complexity to balance sheet reporting and will be a major source of confusion for investors and other financial statement users. Footnote disclosure of fair value information avoids these problems and fulfills the needs of investors and other financial statement users who might want to consider this information. Thus, the footnotes continue to be the appropriate place to disclose fair value information for financial assets measured at amortized cost where the entity's business strategy is to hold them for collection of contractual cash flows.

Finally, FIRCA supports the use of the equity method and we would like to express our concerns over the portion of the Proposal that provides new guidance on the criteria for equity method accounting (Topic 323). It is not clear that there is any need to change the current requirements. Moreover, this topic is outside the scope of financial instruments (Topic 825) and derivatives and hedging (Topic 815). In addition, the new guidance itself is problematic. The Proposal would add another criterion to qualify for equity method accounting over and above significant influence, namely that the entity would need to determine whether the operations of the investee are related to the entity's consolidated business. This screen is not even used for consolidation accounting and reporting and it would have the end result of sweeping a wide variety of other arrangements that are not financial instruments into fair value accounting with changes in fair value recognized in net income each reporting period, which again is inconsistent with the overarching premise that accounting and reporting should reflect an entity's business model.

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### *Impairments*

The Board is proposing some new guidance on the recognition of impairments. In this regard, FIRCA supports the general principle that recognition of an impairment loss in the income statement for financial assets not accounted for at fair value with changes in fair value recognized in net income each reporting period should be based on an expectation of a future loss in cash flows attributable to either a credit loss or an anticipated sale of the asset for a loss.<sup>3</sup> FIRCA also supports the following considerations related to impairments:

- The income statement should reflect a reduction in expected future cash flows from cash flows anticipated at the acquisition date or latest impairment adjustment, if applicable.
- Expected losses should be recognized over the life of the financial assets, not at origination.
- Impairment recognition can be triggered by either an expected sale of an impaired financial instrument or a credit loss resulting from a reduction in expected future cash flows.
- Equity securities do not have an expected cash flow stream. Impairment for equities occurs when it is expected the cost basis will not be recovered in a reasonable time period.
- Recoveries of previous impairments will be allowed, not to exceed cumulative previous impairments recognized.
- Entities that hold securities for the purpose of trading should record all changes in fair value through the income statement alleviating the need for impairment guidance.

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<sup>3</sup> It may be advisable that an expert advisory panel, similar to that convened by the IASB be formed in the United States to conduct formal and thorough outreach to all affected constituents and to determine through field testing the most cost effective, relevant and reliable impairment model, particularly given the possibility that fair value is not extended into new classes of financial assets.

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- Expected cash flows are projected based on all relevant and reliable information available, including historical trends adjusted for current conditions and projected future economic conditions and variables. Use of static assumptions based only upon existing economic and market conditions would be extremely pro-cyclical and not representative of the cash flows the reporting entity expects to receive.
- A financial instrument can be evaluated on either an individual basis for impairment or by using a pooled method. The objective of both methods continues to be to identify a decline in expected cash flows that has occurred since purchase of the instrument(s).
- If a financial instrument is evaluated individually for impairment, a pooled method is not required as a second step of the impairment evaluation.

#### *Financial Liabilities*

The Board is proposing new guidance for accounting and reporting for financial liabilities, whereby such liabilities would be measured at fair value, amortized cost (based on eligibility criteria), or a re-measurement amount specifically applicable to core deposit liabilities. FIRCA respectfully disagrees with the new requirements in this area of the Proposal. Instead, FIRCA believes that the current guidance in GAAP should be retained, which generally requires financial liabilities to be measured at their amortized cost basis that typically is equal to the contractual settlement value. At the same time, a fair value option should be available in situations where financial assets and liabilities are managed together on a fair value basis.

Essentially, the Board is proposing fair value, with all changes in fair value recognized in net income, as the default option for classification and measurement of all financial instruments – whether financial assets or financial liabilities. However, and again consistent with the overarching premise that accounting and reporting should reflect an entity's business model, FIRCA believes that amortized cost should be the default for financial liabilities based on business strategy, as it reflects the actual cash outflows expected to occur. Further, FIRCA is concerned with the proposed guidance that would establish "bright-lines" for the use of amortized cost for financial liabilities (e.g., that the liability is issued by and recorded in, or evaluated by the chief

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operating decision maker as part of an operating segment for which less than 50% of the segment's recognized assets are subsequently measured at fair value or it is the liability of a consolidated entity for which less than 50% of consolidated recognized assets are subsequently measured at fair value).

In addition, consistent with our previous comments on the Proposal with regards to financial statement presentation for financial assets, the presentation on the face of the financial statements of both amortized cost and fair value (or separate presentation of changes in an entity's credit standing, excluding changes in the price of credit, for financial liabilities measured at fair value with all changes in fair value recognized in net income) adds complexity and confusion to the reporting of financial liabilities, which footnote disclosures avoid.

Finally, FIRCA strongly disagrees with the Proposal in regards to the treatment of core deposits. Like non-core deposits, core deposits should be measured and reported at their face amount, as both are demand deposits and this reflects the contractual settlement amount, i.e., the actual cash outflows expected to occur.<sup>4</sup> Moreover, the Board is proposing to introduce new financial reporting complexities in that core deposit liabilities would be re-measured each period using an entirely new approach that would only be applicable to core deposits and which is neither fair value nor amortized cost. Further, the proposed approach is likely to be highly subjective and result in much inconsistency from company to company. The Board recognizes the novel and challenging nature of this guidance and has included it as among the new requirements that would be delayed for an additional 4 years for nonpublic entities with less than \$1 billion in total assets. However, delaying for four years the implementation of selected provisions of the Proposal for a subset of smaller nonpublic entities does not sufficiently appreciate either the conceptual flaws or operational challenges with this aspect of the Proposal for all entities.

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<sup>4</sup> In addition, the issue of core deposit intangible asset as representing a source of value for depository institutions should not be within the scope of this project on financial instruments, as the Proposal is not intended to address the accounting for intangible assets.

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### *Derivatives and Hedging*

For hedge accounting, the Board is replacing what it describes as “highly complex, quantitative-based” hedging requirements with more qualitative-based assessments. FIRCA appreciates the thrust of the Board’s Proposal in this regard and supports the following principles:

- Derivatives may be used to hedge:
  - Exposures to changes in the fair value of a recorded asset or liability or an unrecognized firm commitment (fair value hedges);
  - Exposures to variability in the cash flows of a recognized asset or liability (cash flow hedges);
  - Forecasted transactions (forecasted transaction cash flow hedges);
  - Net investment in a foreign operation;
  - Foreign currency exposure present in other hedging relationships; or
  - An entire asset or liability, a portion of an asset or liability, a portfolio of homogenous assets, a portfolio of homogeneous liabilities, or a specifically-identified risk inherent in an asset or liability.
- At inception and throughout a hedging relationship, the reporting entity should assess the hedge relationship’s effectiveness to ensure the expected economic relationship continues between the hedging instrument and the hedged risk and that changes in fair value of the hedging instrument continue to be reasonably effective (as defined) in offsetting changes in the hedged risk, the variability in hedged cash flows, or foreign currency risk.
  - The ineffective portion of a hedge should be recorded in earnings immediately.

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- If requirements of hedge accounting are no longer met (e.g., the hedge is no longer effective), hedge accounting must be discontinued.
- Hedging instruments may be de-designated and re-designated.
- Derivative assets and liabilities should be carried at fair value on the balance sheet.
- Embedded derivatives should be bifurcated from the host contract and accounted for separately if the economic characteristics and risks of the embedded derivative are not clearly and closely related to the host contract and the embedded derivative has the characteristics of a derivative.

#### *Concluding Comments*

In conclusion, FIRCA supports the premise that accounting and reporting for financial instruments should reflect an entity's business model. However, as discussed in this letter, FIRCA is concerned that, in a number of areas the Board's proposed requirements are inconsistent with this premise and need to be reconsidered. This includes the proposed new requirements for disclosures reconciling amortized cost to fair value on the face of the financial statements, instead of using footnote disclosures to provide this supplemental information.

Additionally, we are concerned about the complexity of and operational challenges in implementing the Proposal. Delaying for four years the implementation of certain provisions of the Proposal for a subset of smaller nonpublic entities does not sufficiently appreciate either the conceptual flaws or operational challenges with the Proposal for all entities.

FIRCA also encourages the FASB and IASB to resolve their differences and develop a converged standard in accordance with the principles we have outlined in this letter. FIRCA seeks to be a part of the process in developing such a converged standard and is prepared to assist FASB and IASB in this endeavor.

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FIRCA understands that FASB intends to subject the Proposal to field testing and visits related to the Proposal and we highly encourage these actions. In turn, the results of field testing should be used to reconsider and revise the Proposal for re-exposure. FIRCA would be pleased to work with the Board to facilitate such field testing and visits.

Finally, as requested, FIRCA is submitting this comment letter by September 1, 2010 in order to participate in the Board's public roundtables in October 2010.

Sincerely,

American Council of Life Insurers  
Commercial Real Estate Finance Council  
Group of North American Insurance Enterprises  
Mortgage Bankers Association  
Property Casualty Insurance Association of America  
The Financial Services Roundtable  
The Real Estate Roundtable  
The U.S. Chamber of Commerce