

April 1, 2011

Technical Director – File Reference No. 2011-150 Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

International Accounting Standards Board 30 Cannon Street London ED4M 6XH United Kingdom Re: FASB and IASB Supplementary Document, *Impairment* ("SD")

Sent via email to director@fasb.org

The Allstate Insurance Company ("Allstate" or "we") is pleased to provide comments to the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB or collectively, Boards) on the SD designed as a joint proposal to address a key element of the future impairment model, specifically recognition of impairment on financial assets managed in open portfolios.

Allstate is the largest publicly held personal lines insurer in the United States with significant life insurance operations as well. Allstate is also a large investor in global debt and equity markets (i.e., our investment portfolio is approximately \$100 billion) and a lender in a significant number of privately negotiated lending arrangements. We have been actively engaged in the Accounting for Financial Instruments (AFI) project for a number of years as we recognize the importance of the project and its potential impact not only on our company, but the global insurance industry.

We appreciate the Boards' efforts to address concerns raised in the feedback and comment letters received on the Boards' original exposure drafts¹. Specifically, we are pleased the Boards developed a joint proposal. However, we have several concerns about the proposal and its application to companies outside the banking industry, as well as how this proposal fits into the overall joint AFI project and its timeline.

Operationality and Applicability to Insurance Industry

We are aware that the staff of the Boards, aided by the Expert Advisory Panel, created this accounting model based upon current business practices in the banking industry for bank loan products. The scope of the proposal, however, applies to open portfolios of loan <u>and</u> debt instruments that are not measured at fair value through net income (FVNI). The investments of insurance companies are predominantly comprised of debt and equity securities which are evaluated individually for impairment. We remain very concerned about the applicability of the SD to our entire population of financial assets not accounted

Proposed Accounting Standards Update—Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815) issued May 2010 and ED/2009/12—Financial Instruments: Amortised Cost and Impairment issued November 2009.

for at FVNI, because this segmentation of assets is inconsistent with our business model. Specifically, we are concerned that this model will be applied to all assets classes (including debt instruments) and industries without sufficient field testing to determine if this approach is appropriate, practical or necessary for other asset classes, much less if it consistent with credit risk management practices outside the banking industry.

We believe the 'too little, too late' criticism is directed at the current U.S. GAAP impairment model for loans and *not* at the current U.S. GAAP impairment model for debt securities since the current U.S. GAAP impairment model provides a solid foundation for recognizing and measuring impairment of those instruments. Furthermore, when sufficient asset, issuer, or borrower-specific information is available for an individual asset, grouping that asset with others and applying expected loss information at a higher level would be inappropriate and result in less meaningful information on expected losses. We are concerned that the reaction to the 'too little, too late' criticism may unnecessarily and inappropriately implicate the current debt security impairment model.

Many questions within the SD inquire about the operationality of the proposal. We find it difficult to provide meaningful comments on the operationality of the SD without having performed a field test of the proposal, particularly given that insurance companies do not manage the majority of their assets on a portfolio basis and do not currently delineate between assets in a 'good book' and those in a 'bad book.' A 60-day comment period is insufficient to perform a reasonable field-test of the model. If the Boards are interested in gathering information about the operationality of the proposal, we strongly urge them to conduct comprehensive field testing of all significant components of the SD along with a critical evaluation of the results before redeliberations on a final standard take place. This field testing should include both banks and insurance companies. Furthermore, the Boards should organize roundtable discussions in order to solicit further feedback from constituents and to better understand the practical implications of its proposal. We also strongly urge the Boards to expose any impairment proposals related to individual assets for public comment prior to finalizing the impairment recognition model.

Lastly, we believe the Boards made a critically important decision in the development of the SD in incorporating a credit risk management approach, and more broadly, in their respective financial instruments standards in adopting a business model approach. The importance of the business model approach is it allows banking institutions to recognize impairment, and classify and measure financial instruments in a manner consistent with their adopted business model. However, the insurer business model has different attributes than the banking business model and those differences need to be considered in developing a broadly-applicable impairment standard. Specifically, we invest in assets to match the cash flows of our insurance liabilities, approximately 65% of our total investments are comprised of bonds, and we manage substantially all of our investments individually. We believe it is critical that the Boards extend the business model approach to other industries and other Board projects in order to provide other entities consistent considerations as those afforded to the banking industry.

AFI Project and Convergence

We acknowledge that the Boards developed the proposal jointly. Despite the joint nature of the project, we are concerned that the Boards will not be able to achieve a single converged standard given the inconsistent project timelines, project structure and certain inconsistent decisions reached by the Boards. For example, within the SD, it is clear that the FASB has not yet discussed and concluded on certain provisions, such as defining the 'foreseeable future,' providing flexibility relating to using discounted amounts, and presentation and disclosure elements. To the extent the inconsistencies persist the Boards may ultimately establish different guidance, potentially creating competitive disadvantages for certain jurisdictions. Allstate believes it is critical for the Boards to develop a fully converged AFI standard and urge them to work together to achieve that goal.

It is difficult to consider all potential implications of the SD given that the scope of the document has been evolving during the exposure period and is inconsistent between Boards. The document indicates that, for the FASB, it applies to open portfolios of loan and debt instruments that are not measured at fair value through net income (FVNI). Since the FASB continues to deliberate the classification and measurement aspects of the accounting for financial instruments, the scope of the document remains a moving target. Therefore, our comments may not consider certain financial instruments that, as a result of future FASB meetings, are scoped into the SD. In addition to the evolving scope of the SD, we believe it is difficult to consider its implications without clarity on other fundamental aspects of the impairment model such as measurement of expected credit losses and interest recognition which are currently being deliberated by the Boards. There are significant interrelationships between the impairment recognition model and impairment measurement and interest recognition that must not be overlooked.

Allstate's detailed responses to the questions in the SD are attached. If the Boards desire a further discussion of our views, please contact me at (847) 402-2213 or Kevin Spataro at (847) 402-0929.

Sincerely,

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Questions from the Financial Instruments: Impairment Supplementary Document

1. Do you believe the approach for recognition of impairment described in this supplementary document deals with this weakness (i.e., delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

We believe the 'too little, too late' criticism is directed at the current U.S. GAAP impairment model for loans and *not* at the current U.S. GAAP impairment model for debt securities. We believe the existing impairment model for debt securities provides a solid foundation for recognizing and measuring impairment for those instruments in a timely manner.

Notwithstanding the above, without performing field testing of the proposal, we have no factual basis for concluding whether the approach for recognition of impairment in the SD addresses the 'too little, too late' criticism. Accordingly, it is imperative that the Boards conduct a field testing exercise to understand the results of the application of the SD and to fully evaluate and conclude whether the results of the SD meet the Boards' objectives.

2. Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

The impairment model proposed in the SD would need to be thoroughly field tested to determine whether it is "at least as operational" for closed portfolios as open portfolios. Insurance companies do not typically have closed portfolios since asset substitution is necessary (due to normal asset maturities) given the long duration of many insurance liabilities. Conceptually, we do not believe the proposed model is suitable for individually-evaluated assets. That is, if assets continue to be evaluated at the individual level using asset-specific information, we do not believe the 'good book'/'bad book' notion is relevant because that approach presupposes asset-specific information is not available, thus necessitating a pooled approach to credit risk evaluation. Additionally, when sufficient asset, issuer, or borrower-specific information is available for an individual asset, grouping that asset with others and applying expected loss information at a higher level would be inappropriate and result in less meaningful information on expected losses.

We do not believe the accounting for impairment should drive the way in which we manage, monitor, and evaluate financial assets; rather the credit risk management model should drive the accounting. Therefore, we believe that it is important to have separate impairment approaches depending on whether assets are evaluated individually or at a portfolio level for internal credit risk management purposes.

3. Do you agree that for financial assets in the 'good book' it is appropriate to recognize the impairment allowance using the approach described above? Why or why not?

We would not object to using the proposed approach to recognize the impairment allowance in the limited circumstances where assets are evaluated in a portfolio. However, with regard to the calculation of the impairment allowance for the 'good book,' we believe the calculation of both a time-proportional amount and foreseeable future amount of expected losses every reporting period creates unnecessary complexity and has no conceptual basis. The two calculations also require the use of different data sets and underlying calculations and assumptions.

4. Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

We would need to perform field testing to determine whether the proposed impairment allowance on a time-proportional basis is operational for assets evaluated in a portfolio. This amount is determined by the expected loss for the remaining life, the weighted average age, and weighted average life of the portfolio. That information may not be currently available for all assets to facilitate calculating the weighted average age and life of the portfolio. Clearly, determining the expected loss for the remaining life of the portfolio is a more complex exercise that may require significant judgment.

As stated in question 3, we support a single calculation of expected credit losses for the foreseeable future. We prefer the 'foreseeable future' approach over the time-proportional approach because we do not believe the time-proportional approach meets the objectives of the conceptual framework. Although field testing may support that the approach is operational, we do not believe it would ultimately result in decision-useful information.

5. Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

We believe the recognition of impairment for the 'good book' would not be decision-useful for users of financial statements without requiring a comprehensive explanation of the continuous recognition of impairment and an analysis of the changes in the composition of the 'good book' from period to period.

We believe significant judgment would be involved in the application of the proposed approach and as a result of the subjectivity and flexibility inherent, comparability will be reduced. In order for users of financial statements to understand the impairment allowances, they will need to understand the numerous assumptions and decisions underlying the calculations. Furthermore, each of the assumptions or choices may change from period to period. As the guidance is currently written, there is no requirement to make consistent elections across periods.

Notwithstanding the factors above, we believe the final impairment model should incorporate an entity's credit risk management. We believe there are ways for the Board to reduce non-comparability while maintaining alignment between the accounting and business activity. For example, the Board could eliminate the option to use a straight-line or annuity method to calculate the time-proportionate amount and/or specify a discount rate to be used. The potential for non-comparability could also be mitigated through expanded disclosures.

From a user perspective, developing an understanding of an entity's impairment allowances under the proposal would require more time and effort than under current impairment models.

6. Is the requirement to differentiate between the two groups (i.e., 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

The requirement to differentiate between the two groups for purposes of determining the impairment allowance is described in sufficient detail. However, the proposal is bank-specific and the standard is intended to be broadly applicable.

7. Is the requirement to differentiate between the two groups (i.e., 'good book' and 'bad book') for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

As stated previously, insurance companies do not manage their assets in a way that delineates between a 'good book' and 'bad book' and we see no compelling reason to change the business model to adopt a 'good book'/'bad book' approach. We gather information we believe is necessary in making the recoverability evaluations at an individual asset level for over 90% of our investments. To implement a 'good book'/'bad book' approach, we would have to develop specific accounting policies, make processes changes, and make necessary system changes in order to capture the data in a way that conforms to the proposed accounting model. In addition, since the proposal represents a departure from the way in which we currently manage and monitor assets, significant one-time costs would be incurred in educating management and investors and training staff. Also, since this proposal is very different from the way we currently manage and monitor assets because substantially all of our assets are currently managed individually, we would have to field test the requirements to determine whether they are operational. Even though the proposed requirement may be operational for certain assets, operationality does not necessarily indicate that it is the best or most appropriate model to use for those assets.

8. Do you agree with the proposed requirement to differentiate between the two groups (i.e., 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

We believe there are certain concepts within the proposed requirement that have merit, such as evaluating assets based on an entity's credit risk management approach, but we do not agree with impairment evaluation explicitly based on the 'good book' / 'bad book' concept because that does not align with our business model. We would propose a model that is applicable to all financial assets subject to impairment and for which impairment recognition and measurement is based on the level of evaluation performed by an entity to monitor and manage the credit risk of the loan or debt instrument (i.e., at the individual or group level).

- 9. The boards are seeking comments with respect to the minimum allowance amount (floor) that would be required under this model. Specifically, on the following issues:
 - a. Do you agree with the proposal to require a floor for the impairment allowance related to the 'good book'? Why or why not?

The proposal to require a 'floor' implies a comparison of two different amounts and as noted in previous responses, we do not agree with requiring two separate calculations. Therefore,

we do not agree with the proposal to require a 'floor' for the impairment allowance. Separately, we might support establishing a 'good book' allowance based on a single calculation of expected credit losses for the foreseeable future, but more field testing is necessary.

b. Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the 'good book' only in circumstances in which there is evidence of an early loss pattern?

We believe the Boards need to establish a clear objective of what the 'good book' allowance represents. Once this is determined at a conceptual level, then recognition and measurement decisions should be made consistent with the conceptual foundation. However, the SD proposes a hybrid model of both Boards' approaches resulting in an unclear overall objective. If the objective of the 'good book' allowance is to cover expected losses over the foreseeable future and the early loss pattern period corresponds with the foreseeable future period, then it seems appropriate to consider the early loss pattern when establishing the 'good book' allowance for impairment.

c. If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?

We believe the Boards need to provide further clarity on 'foreseeable future' in order for it to be a workable concept. The determination of the foreseeable future period will have a significant impact on the derivation of the 'good book' allowance amount. We are concerned that the principle as currently described provides too much flexibility in interpretation. Therefore, we believe implementation guidance, including examples, are required should this concept be incorporated into the final standard.

In addition, we are aware that regulatory bodies in different jurisdictions have certain requirements and precedents for time periods over which to calculate expected losses. We are concerned that this may establish minimum time requirements that are difficult to overcome when determining the foreseeable future period. Significant differences in foreseeable future periods across geographic jurisdictions would further reduce comparability and could potentially put companies in certain jurisdictions at a comparative disadvantage.

d. For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?

We believe the period of time defined as the 'foreseeable future' could change on the basis of changes in economic conditions; however, since we do not currently use this concept and have not field tested the concept, we have no factual basis for determining the interaction between foreseeable future periods and changes in economic conditions.

e. Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.

We believe that for certain portfolios of assets, the foreseeable future period may be greater than twelve months. For example, when analyzing structured securities for impairment, we typically project cash flows over the entire life of the security. However, that is relevant for assets evaluated individually. We do not have data at the portfolio level since we do not currently manage credit risk for assets on a portfolio basis.

f. If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a 'ceiling' should be established for determining the amount of credit impairment to be recognized under the 'floor' requirement (for example, no more than three years after an entity's reporting date)? If so, please provide data and/or reasons to support your response.

As stated in our response to question 9c, we have concerns about the non-comparability resulting from the foreseeable future period determination. However, we are not in favor of establishing a bright-line ceiling to address the potential non-comparability.

10. Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2(a)(i)? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.

Conceptually, we think that whether the floor amount will be equal to or higher than the time-proportional amount is dependent on many different factors, including the asset type, the loss pattern, the length of the foreseeable future, and the stage of the asset's life cycle. However, it is difficult to provide supporting data as insurance companies do not currently apply the concepts of the 'good book/bad book' model to our financial assets. We urge the Boards to conduct comprehensive field testing on the SD to obtain a more thorough understanding of the results of applying the 'good book' approach.

- 11. The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:
 - a. Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the approach described in paragraph B8(a)? Why or why not?
 - b. Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

Allstate believes that the Boards should simplify the calculation of the 'good book' impairment allowance level to a single calculation of the expected credit losses for the foreseeable future. We note that the SD is silent on whether the expected credit losses for the foreseeable future would be a discounted or undiscounted amount. For simplicity, we would favor guidance requiring an undiscounted estimate.

12. Would you prefer the IASB approach for open portfolios of financial assets measured at amortized cost to the common proposal in this document? Why or why not? If you would not prefer this specific IASB approach, do you prefer the general concept of the IASB approach (i.e., to recognize expected credit losses over the life of the assets)? Why or why not?

No, as stated throughout the letter, we do not prefer a time-proportional approach for measuring impairment of financial assets measured at amortized cost as there appears to be no conceptual basis for the requirement.

13. Would you prefer the FASB approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific FASB approach, do you prefer the general concept of this FASB approach (i.e., to recognize currently credit losses expected to occur in the foreseeable future)? Why or why not?

Yes, Allstate would prefer the FASB approach for measuring impairment on assets in the scope of the document to the common proposal. However, as discussed in our response to question 9a, we do not agree with the proposal to require a general reserve related to financial assets managed individually.

The Board's original exposure draft included a requirement for an entity to consider the impairment at the portfolio (or pooled) level after the individual securities are analyzed to determine whether a credit impairment exists. In situations in which an evaluation of the individual securities indicates no credit impairment exists, we do not believe it is appropriate to recognize credit impairment at the pooled level.

Responses to IASB-only Appendix Z Questions

14. Do you agree that the determination of the effective interest rate should be separate from the consideration of expected losses, as opposed to the original IASB proposal, which incorporated expected credit losses in the calculation of the effective interest rate? Why or why not?

Yes, we agree that the determination of the effective interest rate should be separate (i.e., 'decoupled') from the consideration of expected losses. Consistent with the feedback that the IASB received on its original proposal, we do not believe it would be operational to recognize an effective interest rate that integrates expected credit losses.

15. Should all loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37) be subject to the impairment requirements proposed in the supplementary document? Why or why not?

Yes, we agree that all loan commitments not accounted for at FVNI should be subject to the impairment requirements in the SD. This would help ensure consistent impairment recognition for financial instruments for which the basic attributes are the same.

16. Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

For insurers, loan commitments are typically not evaluated at the portfolio level. Therefore, without field testing the proposal, we cannot confirm whether the requirements would be operational for our loan commitments.

We are unsure how the proposed impairment guidance would apply to financial guarantee contracts since we consider financial guarantee contracts to be financial liabilities. We do not believe the proposed model is intended to apply to financial liabilities and therefore, do not believe the guidance should apply to financial guarantee contracts.

17. Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?

We agree with the proposed presentation requirements to separately present interest revenue and impairment losses in the statement of comprehensive income.

- 18. (a) Do you agree with the proposed disclosure requirements? If not, which disclosure requirements do you disagree with and why?
 - (b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) for the proposed impairment model and why?

We generally agree with the proposed disclosure requirements with the exception of the requirements noted below:

• Z6 - Disclosures at the class level. We do not agree with the Board's decision to introduce another basis of grouping assets for disclosure purposes only. If the Board believes that portfolios should be defined on the basis of asset classes, then that requirement should be stated within the accounting standard. However, as the

disclosure requirements are currently stated within the proposal, it does not seem that assets classes necessarily have a relationship to asset portfolios. The disclosures would require entities to provide reconciliations of changes in the allowances for each class of financial assets. This would require entities to allocate portfolio allowance amounts, possibly across multiple portfolios, to asset classes. That seems inconsistent with the portfolio concept underpinning the entire proposed model. Therefore, we do not believe it is appropriate to require disclosures at the asset class level.

- Z12 Back testing disclosure. We do not agree with the requirement for entities that perform back testing to disclose a quantitative analysis that compares the actual outcomes and the previous estimate of expected credit losses. Although it may be prudent for companies to perform back testing procedures, we believe those procedures may be performed on subsets of the portfolio populations at different points in time. We believe it would be difficult to define a population of assets for purposes of back testing and to define a time period over which to perform the testing in a way that results in a meaningful comparison to the amounts of 'good book' and 'bad book' allowances recognized.
- Z15 Requirement to disclose watchlist information. We do not agree with the requirement to disclose a description and the criteria for including and no longer including financial assets in the watchlist, and to disclose how the watchlist relates to the criteria that determine whether the entities applies to 'good book' or 'bad book' approach. We believe that this information is proprietary and should not be required to be disclosed. Furthermore, we believe that the resulting disclosure would be too detailed to be meaningful for the user of financial statements and therefore, the costs of providing this information outweigh the benefits.
- 19. Do you agree with the proposal to transfer an amount of the related allowance reflecting the age of the financial asset when transferring financial assets between the two groups? Why or why not? If not, would you instead prefer to transfer all or none of the expected credit loss of the financial asset?

As stated in paragraph BCZ97, "[t]he IASB considered different alternatives for how the amount should be determined that would be transferred with a financial asset between the ['good book' and 'bad book']...The IASB noted that all three approaches would result in the same effect on profit or loss and that amount in the allowance for the two groups." Since the 'good book' and 'bad book' allowances are re-estimated after the transfer, the purpose of deriving this amount is only to satisfy disclosure requirements. We believe that since the allowance amount to be transferred does not have an accounting impact and is only informational, the calculation should not be overly complex or costly. We believe that calculating the related allowance reflecting the age of the financial asset to be transferred is the most complex of the alternatives and therefore, we are not in favor of it. However, we would not object to either transferring all or none of the expected credit loss of the financial asset.