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May 31, 2013

Ms. Leslie Seidman, Chairman Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference No. 2012-260: Proposed Accounting Standards Update, *Financial Instruments—Credit Losses* (Subtopic 825-15)

Dear Ms. Seidman:

The American Council of Life Insurers (ACLI)¹ appreciates the opportunity to comment on the "Financial Instruments—Credit Losses (Subtopic 825-15) – Exposure Draft" ("ED").

GENERAL COMMENTS

We believe this proposed impairment standard represents a significant improvement from the prior exposure drafts. We have the following comments with respect to certain aspects of the guidance as proposed:

ACLI's Long-Standing Views on the Impairment Project

As expressed in prior ACLI comment letters on the topic of impairment, ACLI is supportive of the incurred loss model in current U.S. GAAP. The incurred loss model relies on current conditions and events to determine if losses have occurred. In the ED's proposed expected loss model, we are concerned about the significant amount of increased subjectivity associated with projecting and reporting future losses (i.e., those losses that have yet to occur). The proposed model uses historical losses and also management's own judgment in projecting future economic and other conditions to estimate future expected losses. We do not believe this approach is an improvement to current U.S. GAAP which primarily relies on current conditions and events to determine if a loss has occurred, both of which are more easily identifiable because they have already occurred and both of which involve significantly less

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¹ The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with more than 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American Families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. Learn more at www.acli.com.

judgment on the part of management. We understand that the Board may have the view that future projections are already incorporated into other areas of U.S.GAAP; however, we believe the significant amounts of judgment needed to project future expected losses introduces unnecessary complexity into the financial statements and reduces comparability.

Should the FASB decide to adopt the expected loss model – the purpose of which is to project future losses – then expectations about future economic and other conditions should be a consideration in projecting future losses. In the FASB's 2010 Financial Instruments ED, the proposal was to consider only past events and existing conditions to project future expected losses. We believe the model should not rely on only past events and current conditions, but also consider future expectations, especially given various volatile economic cycles that could occur.

ACLI has consistently been supportive of using best estimates of losses versus the ED's proposal that requires the use of one scenario that has a probability of loss and one scenario that has no probability of loss. Requiring two scenarios adds complexity and work with no increase in the accuracy of credit losses reported on the financial statements. The use of best estimate has been applied in the U.S. for many years and is easier to apply than the proposed two scenario minimum. Best estimate is also well understood by financial statement users and promotes comparability among financial statement reporters.

Consistent with our reading of the ED, we agree that, if adequate information is available to assess financial assets individually for credit losses (e.g., public information about the borrower; current financial results and measures; etc.), and a reporting entity chooses to evaluate credit losses on an individual basis, it should not be required to then also evaluate credit losses for that same security on a pooled basis. For assets held at fair value, we do not agree that recognizing losses immediately on originated or purchased assets, whose prices already reflect expected future credit losses (i.e., fair value), is appropriate.

ACLI is strongly supportive of convergence between the FASB and IASB in their impairment models.

Finally, we view the current impairment model for debt securities, which was modified during the financial crisis to address concerns surfaced during the financial crisis, as being very effective. The model has been tested ever since FSP FAS 115-2 was adopted and has worked well for debt instruments. FSP FAS 115-2 eliminated the probability threshold in previous U.S. GAAP and continues to allow the use of best estimate to calculate the amount of credit losses. When applying FSP FAS 115-2, it is rare that Life Insurers are questioned by users about the appropriateness of credit losses recognized in the financial statements.

We understand the FASB has several objectives in adopting the proposed impairment model and our long-standing views on the impairment model may not be consistent with the direction the FASB desires to take. Should the FASB decide to adopt the model as proposed in the ED, we would urge the FASB to consider our suggested modifications in our comment letter as detailed below.

SCOPE and DEFINITIONS

The exposure draft appears to expand the previous scope of financial assets that should be evaluated for impairment. We have concerns with the expanded scope, specifically with regard to assets measured at fair value through OCI, intercompany receivables, invested assets that are short-term in nature, cash equivalents, and reinsurance recoverables. We will elaborate on the specific issues in this letter.

We believe that, in various Board discussions, the Board indicated that it would address the issue of intent to sell in the final impairment standard. Although the issue is addressed in the FASB's Recognition and Measurement ED for assets classified and measured at amortized cost ("AC"), it is not clearly addressed for assets measured at fair value with periodic changes in fair value reported in other-comprehensive income ("FV-OCI"). ACLI member discussions indicate a variety of differing interpretations of the proposed guidance with regard to intent to sell and, therefore, differing opinions with respect to comments on the proposed ED. We recommend the Board explicitly state whether or not intent to sell for FV-OCI assets should be handled the same way as those reported at AC.

Assets Measured at Fair Value through OCI

We do not believe FV-OCI assets should be included in the scope of a standard that was principally designed to address loan losses. We strongly believe that the current guidance on FV-OCI assets, which is tried and true, should be retained. We believe the current impairment model for debt securities provides for timely recognition of credit losses and the amount of credit losses recognized is adequate.

The focus of the proposed impairment guidance was primarily to address the "too little, too late" issue highlighted by the financial crisis, characterized by an overstatement of asset values on the balance sheet. The criticisms that have been expressed about loans and the recognition of expected losses are not relevant to securities that are measured at fair value, where the difference between original purchase price (i.e., amortized cost) and current fair value is recognized in earnings or in other comprehensive income (OCI). The fair value of these assets already includes a factor for expected losses and as such recognition of a further allowance is unnecessary. Any additional losses recognized through net income would be immediately offset by an unrealized gain in other comprehensive income to arrive back at the fair value that is the carrying value.

The measurement attribute of FV-OCI ensures that the balance sheet measurement of FV-OCI assets will not be overstated. The proposal results in added complexity by requiring an allowance that is effectively offset within OCI (i.e., no matter what amount is recorded as an allowance, the net balance reported on the balance sheet for FV-OCI assets is fair value). While we believe the current impairment model for FV-OCI assets provides for timely recognition of credit losses as we already discussed, we believe that any additional information deemed necessary should be included in the disclosures, if included in a comprehensive reform of the disclosure guidance. We believe the disclosures would allow for appropriate comparisons to be made by users without adding complexity to the face of the financial statements.

Practical Expedient

If the Board does not exclude FV-OCI assets from the scope of this guidance, we agree with the objective of providing the practical expedient; however we recommend the guidance be modified so that a practical expedient can be used if either (1) the fair value of the financial asset is greater than (or equal to the amortized cost basis) or (2) expected credit losses on the financial asset are insignificant. We do not believe the application of the practical expedient should be dependent upon whether or not a financial asset is in an unrealized gain, as many high quality assets (e.g., government securities or other highly rated debt securities) could be in an unrealized gain one period and an unrealized loss the next period if interest rates increase. That would result in no valuation allowance being recorded in the first period and one being recorded in the subsequent period when the credit risk for the security has not changed.

By permitting exclusion for either instruments with insignificant losses or fair value greater than amortized cost, the guidance would reduce operational burdens and complexities for all assets whose characteristics at the reporting date would indicate that the determination of an allowance for future

losses may be neither meaningful nor significant to the current reporting period. In addition, this adjustment to the criteria of the practical expedient would more closely align this proposed model with the current impairment guidance for FV-OCI and simplify the required disclosures.

We also recommend the practical expedient be expanded to be applied to financial instruments that are short-term in nature (i.e., less than one year) if the losses are expected to be insignificant. We believe this would resolve concerns over certain assets that have been scoped into this guidance such as intercompany receivables, short-term assets, cash equivalents and reinsurance recoverables. This would reduce the operational burden of assessing insignificant items for purposes of expected losses.

While we appreciate the attempt to create a principle-based, single approach to impairment, we believe the current proposal oversimplifies the wide range of types of financial assets and market conditions within which we report, and our proposal with respect to the practical expedient would reduce our concerns.

IMPACT ON INVESTMENT INCOME

The ED would significantly change current practice with regard to the recognition of investment income. In general, debt securities currently have established guidance to allow the amortized cost basis, as well as written down amortized cost basis, to accrete to the best estimate of an entity's future cash flows. The accretion approach to income recognition centers on the premise that the cost basis of a financial instrument is the present value of the future projected cash flows. This concept was solidified with the adoption of FSP FAS 115-2 in early 2009 that modified existing practice of non-accrual, cash basis or cost recovery and focused on the fact that the written down cost basis of other-than- temporarily-impaired securities as well as non-impaired securities were indeed the present value of the future projected cash flows. We believe these concepts are appropriate and would recommend they continue to be applied in the new impairment model. In order to achieve this objective, the Board could remove the proposed non-accrual guidance and retain the existing guidance in FSP FAS 115-2 or would need to significantly modify the interest income recognition guidance to be based on the net recorded investment (AC less credit loss reserve).

Financial statements of many companies typically record investment income earned separately from credit losses because of what they represent. Investment income is perceived as the return on the adjusted cost basis of invested assets and is generally a level yield over the life of the instrument while credit losses are a loss on the original investment that is perceived to be more volatile as credit markets shift or as the borrower experiences financial difficulties and a write-down is warranted. For Life Insurers, investment income is an important measurement as it is often matched against crediting rates on liabilities to project future income from operations. The effect of the current proposal would likely create an unwarranted significant reduction in investment income for many companies as a result of the proposed non-accrual guidance.

We urge the Board to consider the impact of this guidance to insurance company income statements. A critical measure of financial well-being is in the reporting of operating income, which typically excludes gains/losses, but includes investment income. We continue to be concerned about the impact of the proposed guidance on the reporting of insurance company investment income and the potential of reclassification of some income to non-operating reporting lines.

DEFERRED TAX ASSETS

We believe an unintended consequence of the proposed impairment model is that deferred tax assets (DTA, DTAs) related to establishing expected credit losses will be treated differently from unrealized

losses recognized in OCI despite an entity's best estimate that no loss will ever be recognized for tax purposes if the entity expected to hold the asset to recovery/maturity. The DTA guidance included in the Classification and Measurement (C&M) proposal was included to address instances where DTAs are created for unrealized losses recognized in OCI where an entity's best estimate indicates the amortized cost basis is recoverable. By changing the impairment model to reflect expected credit losses, there would effectively be a portion of the unrealized loss in OCI that will be reduced by establishing an expected credit loss reserve. As a result, the issue that was being addressed in the C&M proposal would no longer be the unrealized losses based on an entity's best estimate; rather, the amount in OCI would be reduced because realized losses would be based on probability-weighted expected losses. Similar to our comments on the C&M proposal, we believe the Board should allow DTAs related to unrealized losses (whether recognized in income or OCI) to continue to be considered recoverable if the reporting entity expects to recover the amortized cost basis (using its best estimate) and has the intent to hold the assets until recovery.

TRANSITION

In considering the transition guidance for the ED, we urge the Board to consider the operational implications of determining the cumulative effect adjustment that may need to be applied upon adoption of the proposed standard and provide more guidance surrounding the transition approach to be applied as we do not believe it is clear. Our interpretations of the cumulative effect adjustment and related concerns are detailed below.

Although the operational impacts differ among our member companies, many companies have expressed concern specific to debt securities, especially for structured securities. Under current accounting guidance for debt securities, a security is deemed to be other-than-temporarily impaired if the expected present value of the cash flows to be collected from the security are less than the security's amortized cost. If the cash flows are less than amortized cost, the amortized cost of the security is written down for the amount of the calculated impairment, which is different from loans where a valuation allowance is set up.

Under current guidance, many insurance companies have impaired a large number of securities within their portfolios as result of the recent credit crisis. Calculating the cumulative effect adjustment means that insurers would be required to retrospectively reverse cumulative other-than-temporary impairments ("OTTIs") recorded on those securities and adjust the same securities for any principal payments that have been received from the time the security was impaired in order to determine the "unimpaired amortized cost basis". This is further complicated if the security was purchased at a discount or premium to par. We would like to bring to your attention that this would require a significant level of effort. Some insurance companies have hundreds of holdings (i.e., trade lots) that have been impaired under current guidance. There is currently no automated way to calculate such reversals. For example, assume that we purchased an RMBS at \$100 that was subsequently impaired to \$80. Subsequent to the impairment, we received \$30 in principal payments. Upon adoption of the standard, it would not be accurate to just add the \$20 of cumulative OTTI to the current book value since the OTTI amount was done on a basis of 100, not the current \$50 of amortized cost. We would probably have to perform some type of allocation of the cumulative OTTI to the current book value to determine the new cost. This process would have to be performed manually for most insurers, which would take up significant resources and time.

In addition, we assume the cumulative effect adjustment would also need to incorporate the non-accrual provision of the proposal. Insurers would have to analyze all securities that are impaired under current guidance to determine which ones would fall into the non-accrual definition. For such identified securities, insurers would need to reverse all interest payments recorded on such securities and apply them to the amortized cost of each security, if cost recovery is required, for example. Additionally, the cumulative effect adjustment would have downstream operational impacts to financial line items such

as deferred acquisition costs and recoverability of deferred tax assets. Calculating the cumulative effect on these items would require a significant level of effort.

Should the Board decide to exclude FV-OCI (especially, debt instruments) from the scope of the proposed guidance, our operational concerns would be alleviated for the transition adjustments on debt securities. As already mentioned, the same concerns regarding transition adjustments do not exist for loans. Otherwise, the transition impacts summarized above should be key considerations when determining the effective date of the proposed guidance (see Effective Date section of our comment letter).

DISCLOSURES

We continue to be concerned about the increase in quarterly disclosure requirements each time the FASB issues a new ASU. As a result, we would recommend the disclosures being proposed in the ED be required annually and only quarterly if significant changes have occurred since year-end.

ACLI companies also recommend the FASB coordinate the disclosure requirements with the SEC and determine if the proposals are duplicative and/or determine if certain disclosures currently required may be eliminated as they would be no longer relevant. Certain proposed disclosures, such as the roll-forward of amortized cost and FV-OCI assets, including purchases, sales, repayments, etc. would require significant amounts of work, where the only information that is being provided that is relevant to the impairment project is the reporting of the write-offs. As a result, we would suggest re-evaluating the proposed disclosures to require only relevant information to the expected losses be provided.

We are also concerned about the extent to which managements' judgments will be required to be disclosed in footnotes that are not protected by Safe Harbor rules and thus recommend those judgments be better reported in the MD&A.

COST BENEFIT ANALYSIS

We do not believe the costs of implementing a new impairment model for FV-OCI instruments outweigh the benefits, as we believe the proposed model overreaches and therefore does not accomplish the objectives set forth in the Boards' discussions around the need for updated impairment loss guidance. As a result, the implementation and on-going costs associated with adjusting to an expected loss model for all financial assets outweigh the benefits. Some member companies have estimated the loan loss allowance for their portfolio would likely be relatively small compared to the size of the investment portfolio, although significant resources would be required to adjust processes and create auditable support. Once the loan loss allowance is provisioned for at the time of adoption, the allowance would only change due to significant changes in the size of the portfolio (generally not expected); significant changes in credit quality of the portfolio (generally not expected); and a tail event, such as the financial crisis. If a tail event does occur, the reserve would be increased at that time or perhaps only slightly in advance of what would otherwise be recorded as an impairment under existing guidance. Yet, again, significant resources would be required to adjust processes for the on-going analysis. With regard to the concern of "too little, too late" raised because of inadequate reserves for amortized cost assets, although an allowance would be in place, until the event occurs or is projected to occur, it would not be significant enough to cover the unforeseen tail event.

EFFECTIVE DATE

As the Financial Instrument project's Impairment proposal is directly related to the Classification and Measurement proposal, we recommend that the effective dates coincide. Additionally, given the interaction of the Financial Instrument projects (Classification and Measurement as well as Impairment) and the Insurance Contracts project, we recommend the Board align the effective date of the Financial Instruments projects with the effective date of the Insurance Contracts project. In the event that alignment of the effective dates with the Insurance Contracts project is not possible, the Board should consider permitting an insurance entity to defer the adoption of the proposed guidance until the effective date of any changes to the Insurance Contracts guidance. We do, however, acknowledge and support the tentative decision of the Board with respect to the Insurance Contracts project that provides a reporting entity the option to adopt certain aspects of Classification & Measurement retrospectively in conjunction with the retrospective adoption of the proposed Insurance Contracts standard.

The following Appendix provides answers to the specific ED questions in light of our expressed views.

Sincerely,

Michael Monahan

Senior Director, Accounting Policy

cc: Technical Director

APPENDIX QUESTIONS FOR RESPONDENTS

Scope

Question for All Respondents

Question 1: Do you agree with the scope of financial assets that are included in this proposed Update? If not, which other financial assets do you believe should be included or excluded? Why?

No. We do not agree with the scope of financial assets that are included in this proposed Update for the following reasons.

- Reinsurance recoverables
 - We do not support including reinsurance recoverables within the scope of credit loss assessment of financial instruments. We believe that they should remain within the scope of ASC 944 as they are directly linked to losses being projected through the Insurance Contracts accounting guidance. We note that IASB's tentative decision is to subject reinsurance recoverables to insurance accounting. We also recommend that the Board consider coordinating any further comment letter process and the effective dates of this project and the Insurance Contracts project.
- Intercompany receivables and Related Party transactions
 We believe that intercompany receivables should not require an allowance when reported in subsidiary-level
 stand-alone financial statements. We request the Board to make clear the reporting requirements for
 subsidiary-level stand-alone financial statements.
- Assets reported at FV-OCI

We recognize that the scope of the proposed guidance includes financial assets reported at FV-OCI. As indicated in our general comments, we do not believe FV-OCI assets should be included in the scope of a standard that addresses non-security financial instruments, i.e., loans and receivables. The criticisms that have been primarily expressed about loans and the recognition of expected losses are not relevant to securities that are measured at fair value. The focus of the updated impairment guidance was primarily to address the "too little, too late" issue highlighted by the recent financial crisis, characterized by an overstatement of asset values on the balance sheet. This was not an issue for assets reported at fair value and where the difference between original purchase price and current value is recognized in earnings or in other comprehensive income (OCI). These assets are not overstated as market value typically includes a discount for expected losses.

The measurement attribute of FV-OCI ensures that the balance sheet measurement of the FV-OCI assets will not be overstated. This proposal results in added complexity by requiring a reserve that is effectively offset within OCI. The current impairment model for debt securities provides for timely recognition of credit losses. Further credit loss information deemed necessary should be included in the disclosures, if included in the context of overall review and reform to disclosure guidance. We believe the disclosures would allow for appropriate comparisons to be made by users without the added complexity to the face of the financial statements.

We partially agree with the scope of the practical expedient, recognizing it would be applied only to financial
assets measured FV-OCI, except that we recommend that Board consider expanding the scope to include
short-term (i.e., less than one year) financial assets categorized as financial assets carried at amortized cost.

With regard to the ED's proposed criteria for applying the practical expedient method:

1) For financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income, OCI (as opposed to earnings) already reflects the expected loss. In addition, these assets are carried at fair value on the balance sheet. Thus, unlike financial assets carried at amortized cost,

financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income will not be overstated on the balance sheet

2). Interest environments may change such that the practical expedient election may no longer be available, e.g., when interest rates increase. Thus, with regard to the ED's criteria for applying the practical expedient [i.e., (a) "the fair value of the individual financial asset is greater than (or equal to) the amortized cost amount of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant"], we recommend that the criteria be either (a) or (b), instead of both (a) and (b).

3) Interest-related and Intent to Sell:

The Board, in previous discussions, had indicated that they would address the issue of intent to sell and its implications for interest-related losses in the final impairment standard. However, this issue is not clearly addressed in the subject ED. Thus, we believe it should be explicitly addressed.

4) Purchased credit impaired assets

We are concerned that the definition of PCI assets is too broad, such that assets purchased at a discount may be inappropriately scoped in when the credit rating has declined since issuance. Further, the ED is not clear about whether or not to place the asset on a non-accrual status if the entity does not expect to collect full amount of principal, nor is the ED clear about "day 2" accounting.

5) Policy loans

We believe that policy loans (monies advanced to insurance policy holders under the terms of the insurance contract) would not be in scope for this exposure draft and expect them to be addressed in the insurance contracts ED. Also, we note that policy loans are issued by insurance companies against the cash value of life insurance policies and they have no history of losses and no possibility of loss. The loan is less than the insurance liability and would always be recoverable as a reduction to any payout under the insurance liability. We request the Board explicitly exclude policy loans from the scope.

Recognition and Measurement

Questions for Preparers and Auditors

Question 9: The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the financial assets' remaining contractual cash flows. Do you foresee any significant operability or auditing concerns or constraints in basing the estimate of expected credit losses on such information?

Yes. We foresee significant operational and auditing concerns and constraints as elaborated below.

At present, for debt securities, some entities do not have their own historical loss experience data readily available in the accounting system. Thus, entities may be forced to rely on industry data which may not be a good reflection of an entity's specific experience. Nor are we certain what industry data is best for entities to use for purpose of impairment assessments.

Furthermore, the ED does not provide implementation guidance on how to determine the historical loss experience data, e.g., how to track a particular investment in a debt security to determine its historical loss data as the entity evaluates whether or not or when to sell the debt security as its credit worthiness deteriorates. Because companies manage their portfolios and sell based on expectations, historical loss rates may not be indicative of the future performance of its securities. In addition, historical losses are difficult to accumulate given an increase in restructurings. If the Board decides to adopt this model, implementation guidance is necessary to ensure operability and comparability.

Auditability of both the valuations and the disclosures remains a significant concern as we move to a model that includes forecasted expectations. We continue to express strong concern over the increased volume of disclosures that overwhelm the message of the financial statements. Inclusion of each company's various perspectives on the

future performance of the volume of securities held will significantly add to the length of disclosures and comparability among companies, even of similar makeup. There will be a significant cost in resources and it will be an impediment to timely filing for auditors and preparers.

Question 10: The Board expects that many entities initially will base their estimates on historical loss data for particular types of assets and then will update that historical data to reflect current conditions and reasonable and supportable forecasts of the future. Do entities currently have access to historical loss data and to data to update that historical information to reflect current conditions and reasonable and supportable forecasts of the future? If so, how would this data be utilized in implementing the proposed amendments? If not, is another form of data currently available that may allow the entity to achieve the objective of the proposed amendments until it has access to historical loss data or to specific data that reflects current conditions and reasonable and supportable forecasts?

As we state in Question 9, at present, for debt securities, some entities do not have their own historical loss experience data readily available in the accounting system. Data from rating agencies may be available, but they would either be entirely based on historical data or would be difficult to modify in a meaningful way to incorporate current conditions and reasonable/supportable forecasts of the future given the historical data was collected over multiple credit cycles and would not be easily calibrated to the current credit cycle. As a result, many insurers may need to heavily rely on historical default studies produced by third parties for securities. While such information may provide the necessary information to calculate the expected credit loss allowance under the proposal, users could gather similar information through enhanced credit quality disclosures while alleviating the burden on preparers to quantify the amount of expected credit losses.

Question 11: The proposed amendments would require that an estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results. This proposal would prohibit an entity from estimating expected credit losses based solely on the most likely outcome (that is, the statistical mode). As described in the Implementation Guidance and Illustrations Section of Subtopic 825-15, the Board believes that many commonly used methods already implicitly satisfy this requirement. Do you foresee any significant operability or auditing concerns or constraints in having the estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results?

ACLI member companies have several concerns with the proposed guidance surrounding the estimate of expected credit losses:

- The proposed guidance would seem to imply that for high credit quality or government securities, where there is very little or no expectation of a credit loss, a reporting entity would still be required to provide for a "possibility" of loss. This is one of the reasons we believe the criteria for the practical expedient should be amended to allow for either one of the criteria to scope out securities that are expected to have insignificant losses, whether or not the market value is currently above the amortized cost.
- When considering historical loss rates (which we assume would be calculated by including losses from the sale of securities), we recognize that these rates include losses that were interest-related. It is not clear how loss rates should be adjusted to compensate for the effect of past interest-related losses.
- Structured securities are currently modeled using hundreds of scenarios. Where none of the scenarios on high-quality assets indicate a loss, it does not seem appropriate to manufacture a scenario which contains the possibility of a loss in order to comply with the standard.

Question 12: The proposed amendments would require that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly. Methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of the amortized cost amount written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic to the amortized cost balance as of the reporting date to estimate the portion of the recorded amortized cost basis that is not expected to be recovered because of credit loss. Such methods may include loss-rate methods, roll-rate methods, probability-of-default methods, and a provision matrix method using loss factors. Do you foresee any significant operability or auditing concerns or constraints with the proposal that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly? If time value of money should not be contemplated, how would such an approach reconcile with the objective of the amortized cost framework?

We agree that the allowance for credit losses should reflect the time value of money.

Question 13: For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be recognized as interest income. Apart from this proposal, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for expected credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you foresee any significant operability or auditing concerns or constraints in determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition?

ACLI companies believe that the proposal's new definition of a purchased credit-impaired (PCI) asset is not consistent with the actual economic loss on an asset since it focuses on significant credit deterioration rather than the individual assessment of that particular asset's collectability based on best estimate cash flows as currently defined under SOP 03-1. This may cause more assets to be scoped into this aspect of the impairment model than would otherwise be appropriate. For example, if an entity acquired an asset which at origination was an AA, but was purchased at BBB, not expecting further loss, it is not clear whether this would be deemed to meet the definition of significant deterioration since origination. It is also not clear whether this is an overlap with the rest of the guidance. When assessed individually, most companies' best estimate of a BBB asset would be that all principal and interest would be collectible; however, income recognition may be significantly reduced if the scope of assets designated as a purchase credit-impaired financial asset is too broad. Additionally, see our comments regarding income recognition at Question 15.

This concern also presents operational problems in having to analyze every security we purchase for changes in rating since origination and setting parameters that currently do not exist for determining whether an asset is a PCI asset. Additionally, an operational concern would be excluding from income accretion the initial amount attributable to the expected credit losses at the acquisition date. For example, a structured financial asset with partial prepayment options of the underlying pool of assets has constantly changing cash flows expectations.

We recommend the Board retain the current definition of PCI assets.

Question 14: As a practical expedient, the proposed amendments would allow an entity to not recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost basis of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. Do you foresee any significant operability or auditing concerns or constraints in determining whether an entity has met the criteria to apply the practical expedient or in applying it?

No. We do not foresee any operability or auditing concerns with respect to the criteria for applying the practical expedient. We do believe the practical expedient, as written, will not provide any cost savings as financial assets may move in and out of the expedient based on solely interest rate changes requiring the high quality, auditable processes for establishing and disclosing the credit loss allowance. We also have operational concerns with respect to tracking roll-forward information. In addition, we recommend that the practical expedient criteria be applied individually and separately rather than in conjunction with one another for reasons discussed above. Financial assets with the expectation of insignificant losses should not require an allowance or the related disclosures.

Question 15: The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this proposal will change current practice? Do you foresee any significant operability or auditing concerns with this proposed amendment?

Yes. This proposal will significantly change current practice. Current practice on the recognition of future cash flows on debt securities has already been established by FAS 91, EITF 99-20 and SOP 03-3. Additionally, the recognition of credit losses and investment income in the income statement was previously modified by FSP FAS 115-2 in early 2009. This staff position modified previous guidance by eliminating the probable threshold and requiring the establishment of a new cost basis after write-down and allows accretion up to the future projected cash flows. Financial instruments, such as debt securities, are currently held at fair value on the balance sheet with the difference between the fair value and the amortized cost basis being recorded in either other comprehensive income or the income statement based on its FAS 115 classification. Whether cost is the initial purchase price or the written down cost basis, the amortized cost represents the present value of the future projected cash flows on the individual security and the effective yield. Current GAAP, as well as Statutory Accounting Practices prescribed by Insurance Regulators, requires entities to accrete (or amortize) the cost basis of debt securities to the future value using the effective yield that may either be on the prospective or retrospective method based on the specific guidance and we believe such an interest method is appropriate.

In addition, we have the following concerns:

- We do not agree with the proposal's significant reduction of investment income on debt securities. As
 discussed earlier, the separation of investment income and the allowance in net income is an important
 distinction for insurers. We believe the cost basis of a financial asset should continue to represent the
 present value of future benefits and the accretion between the present value and the future value should be
 recorded as investment income.
- We do not agree with the progression from non-accrual to cash basis to the cost recovery method pursuant to 825-15-25-10 as this is contrary to existing practice pursuant to FSP FAS 115-2.
- We do not agree with the income recognition of a PCI financial asset because it reduces the amount of
 income earned through a reduction in amounts accreted through the application of the level yield. If the
 accretion of PCI (purchased credit impaired assets) is based on the original effective yield, changes in cash
 flows would flow through the allowance, rather than interest income, which is significantly different from
 current reporting practice. Also, we are uncertain as to whether or not, based on the non-accrual guidance
 being proposed, all PCI assets would be on non-accrual, thus eliminating income recognition altogether.
- This proposal eliminates many of the relevant concepts formerly established by existing accounting guidance. So, it is not clear whether the yield adjustment for prepayment sensitive assets would be retrospective or prospective. If the yield stays the same, all changes in cash flows would be immediately reflected in the loss allowance. This would result in reporting of net investment income differently, since the changes would be reflected in realized gains and losses.
- An example of prepayment-sensitive assets would be securitized residential or commercial mortgage loans. ACLI members own significant amounts of these types of securities. Pursuant to FSP FAS 115-2, credit losses that are other-than-temporary based on the estimate of future cash flows require the write down of the cost basis. The credit loss is directly related to only a portion of loans in which investors believe the timing and amount of cash flows was adversely affected. The remaining loans are typically performing and producing investment income for the trust that are passed on to investors. Therefore, FSP FAS 115-2 prescribes the earning of investment income based on the effective yield as the cost basis of the security accretes to the likely future cash flows.

An alternative to the proposed guidance on investment income recognition would be to follow established guidance around debt securities in which the adjusted cost basis of a debt security accretes to the future value of the best estimate cash flows. Subsequent changes to cash flows affect the amortization pattern either retrospectively or prospectively. Many investment administration systems are able to accrete to a future value based on a series of expected cash flows that may or may not include the full return of the original face value of the loan or security.

Questions for All Respondents

Question 16: Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45–BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor's effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as

troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

We do not believe that the distinction between types of modifications to debt instruments provides relevant information, nor is the TDR designation warranted. The TDR designation primarily provided a threshold for immediate recognition of a gain or loss upon significant change in the terms of the debt security due to debtor's financial difficulties. Elimination of that designation, replacing it with the guidance in this proposal, would provide for timely recognition of losses.

Disclosures

Questions for Preparers and Auditors

Question 18: Do you foresee any significant operability or auditing concerns or constraints in complying with the disclosure proposals in the proposed Update?

As we have stated in previous comment letters, we have strong concerns about the continuing ballooning of disclosures. We believe that additional disclosures should only be added in light of an overall review and reform of disclosure guidance with an eye to simplicity, clarity and efficiency of communication.

Implementation Guidance and Illustrations

Questions for All Respondents

Question 19: Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient? If not, what additional guidance or examples are needed?

Several aspects of the guidance remain unclear, requiring further clarification through implementation guidance and/or illustrative examples:

- Reporting of investment income versus losses for insurance companies
- Evaluation and reporting of DTAs
- Calculation of the cumulative transition adjustment
- Effect of a change in management's intent from holding an asset for possible sale versus intending to sell a specific asset
- Interpretations around the definition of PCI assets

Transition and Effective Date Questions for All Respondents

Question 20: Do you agree with the transition provision in this proposed Update? If not, why?

As the Financial Instrument project's Impairment proposal is directly related to the Classification and Measurement proposal, we recommend that the effective dates coincide. Additionally, given the interaction of the Financial Instruments project (Classification and Measurement as well as Impairment) and the Insurance Contract project, we recommend the Board align the effective date of any changes from the Financial Instruments project with any changes that result from the Insurance Contracts project. While adopting two significant accounting standards at the same time may create an additional burden on preparers, the alignment of these dates will avoid confusion on the part of users given the two standards are so closely linked.

Regardless of whether the Board aligns the effective date with any changes in the Insurance Contracts or Classification and Measurement project, we recommend an effective date of no earlier than 24 to 36 months after the standard is issued. Depending on the final changes required under the Impairment proposal, companies may need to develop many processes and related controls that could be very time consuming. As a result, companies would need an extended amount of time to adequately prepare processes and systems for these changes at the same time many changes may be occurring as a result of any new Classification and Measurement proposal that is issued. Given the proposals in both of the Financial Instruments EDs would impact many of the same resources; an

effective date of 24 to 36 months after the standard is issued would be needed to ensure companies are prepared to implement the proposed guidance.

Question 21: Do you agree that early adoption should not be permitted? If not, why?

We agree that early adoption should not be permitted. For insurance companies, the impact on our asset/liability management could be significant without thorough analysis and coordinated implementation with changes in guidance for insurance contracts.

Question 22: Do you believe that the effective date should be the same for a public entity as it is for a nonpublic entity? If not, why?

As a result of our recommendation in Question 20 related to the timing of the effective date, we believe there would be sufficient time for both public and nonpublic entities to implement any changes associated with Impairment during that time period.

This guidance represents a significant change in accounting for credit losses for financial instruments and will require IT systems program adjustments, process adjustments, a re-evaluation of internal controls, and crossfunctional training. Consequently, we believe that the effective date should be at a time for both public and nonpublic companies that will allow for sufficient attention and resources to be redeployed for this project, a minimum of 24 months from the date of issuance. For insurance companies, it is critical that this guidance be evaluated and implemented in conjunction with the upcoming insurance contracts standards

Questions for Preparers and Auditors

Question 23: Do you believe that the transition provision in this proposed Update is operable? If not, why?

No. Under the proposal, most member companies believe that the cumulative adjustment could only be accurately calculated for certain security types by determining credit losses taken to date on the current portfolio, reversing out those previously taken credit losses, calculating the original expected credit losses under the guidance, updating the original cost for principal payments to get an unimpaired amortized cost, and booking the difference between the original expectation and the current expectation to retained earnings, and setting up the remainder of current expected losses as the allowance. On a portfolio of thousands of holdings, which have been bought and sold over many reporting periods, we do not believe that an accurate cumulative adjustment is feasible. Without the detailed approach to implementation that we describe above, we believe the cumulative adjustment may be overstated for losses already taken, if a short-cut method is applied.

This dilemma would largely be resolved by eliminating the requirement for FV-OCI assets to be included in this guidance, as we've recommended.

Question 24: How much time would be needed to implement the proposed guidance? What type of system and process changes would be necessary to implement the proposed guidance?

As stated in Q22, this guidance represents a significant change in accounting for credit losses for financial instruments and will require IT systems program adjustments, process adjustments, a re-evaluation of internal controls, and cross-functional training. Consequently, we believe that the effective date should be at a time for both public and nonpublic companies that will allow for sufficient attention and resources to be redeployed for this project, a minimum of 24 months from the date of issuance. For insurance companies, it is critical that this guidance be evaluated and implemented in conjunction with the upcoming Insurance Contracts standards.

Significant systems changes would be required in the following areas:

- Calculation and reporting of interest income
- Tracking of individual securities impairments for impact on pooled allowances

Process changes would be required in the following areas:

- Development of historical loss data at a lower level than for each asset type
- Analysis of changes in conditions since inception for each asset type that would affect the historical loss data
- Detailed analyses of losses in OCI to determine credit portion to be reclassed to the P&L
- Analysis of debt securities as of acquisition for significant credit deterioration since original issuance to identify PCI assets
- Re-evaluation of key controls around the impairment process

Significant retraining of personnel, including management, would be required throughout the organization to incorporate new concepts and calculations.