

## AMERICAN INTERNATIONAL GROUP, INC.



April 6, 2011

Sir David Tweedie, Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

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

Re: FASB File Reference No. 2011-150, *Supplementary Document – Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Impairment*

AIG appreciates the opportunity to comment on the supplementary document, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Impairment* (“SD”). We believe the Financial Accounting Standards Board (“FASB”) and the International Accounting Standards Board (“IASB”) (together “Boards”) should work toward a comprehensive, single, high-quality standard addressing the accounting for financial instruments. AIG supports the efforts of the Boards to pursue changes to their initially-proposed impairment models.

A summary of our most significant observations regarding the SD follows. Refer to our complete responses in the Appendix for our supporting rationale.

### **Views on the Proposed Impairment Model**

- We support the Boards’ efforts to arrive at a converged approach on credit impairment which will result in a more timely loss recognition; however, we believe the proposed approach is significantly more complex and operationally challenging than is necessary and would produce information that is more difficult for users to understand than that produced under current impairment standards.
- We agree with the SD’s proposal to determine expected credit losses for financial assets based on all available information that includes all reasonable and supportable forecasts of future events and economic conditions in addition to historical data and current economic conditions.
- We support the Boards in their proposal to decouple credit losses from interest income recognition, although we have concerns about how the SD, once finalized, would impact the

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interest income recognition part of the project, because the FASB has yet to deliberate on this topic.

- We agree with the proposal to review certain financial assets for impairment on a portfolio basis (“open portfolio” concept), however we do not believe that all financial asset classes held by entities in all industries could be grouped into portfolios because this is not how they are managed in every case, and we do not believe this would result in improved accounting in all cases.

As we expressed in our comments on the FASB’s previous proposal, File Reference No. 1810-100—Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (“*Financial Instruments*”), we disagree with a *requirement* that an individual asset be assessed with other assets to determine whether a credit impairment exists. We believe a company should be permitted to *consider* assessing such an asset together with other similar financial assets for collective impairment.

AIG’s financial assets are not managed on a collective basis but rather on an individual basis. Such financial assets have unique risk profiles and other characteristics, and therefore do not allow for a portfolio basis impairment methodology that might be more applicable to asset groups that are smaller in size, large in number, and homogeneous in nature. Thus, the scope of the SD does not appear to reflect the investment strategy and risk management processes of how an insurance enterprise manages its investment portfolio and would be impractical to implement. Consequently, we believe financial assets managed on an individual basis are outside the scope of the proposed SD. However, we are concerned that some of the concepts of the SD will be applied to financial assets currently managed on an individual basis and we suggest the Boards reconsider their proposals.

- We suggest the Boards amend the proposal to mirror the existing impairment guidance for *debt securities* within the scope of Accounting Standards Codification (“ASC”) 320-10-35 (under which adverse changes in expected cash flows result in periodic credit impairment loss recognition). This methodology coupled with lowering the threshold of when credit losses should be recognized on *loans* within the scope of ASC 310-10-35 from ‘probable’ to ‘more likely than not’ and the inclusion of a ‘foreseeable future’ concept at a given reporting date would improve the current incurred-loss model for loans, appropriately accelerate the recognition of loan losses, and provide a uniform methodology for financial assets individually assessed for impairment.
- Further, we believe it is inappropriate to recognize a credit impairment loss upon origination or purchase of a financial asset, whether an individual or portfolio method for evaluating credit impairment is used, if the financial asset is performing. To do so would indicate the financial asset was not originated or purchased at fair value, which is inconsistent with the substance of the transaction and does not reflect the perspective of a market participant.
- Additionally, we do not agree with the concept of the allowance for credit losses being attributable to debt securities. As we communicated in our response to the FASB’s previous proposal on *Financial Instruments*, we do not believe the SD’s proposal to create an allowance for each credit-impaired debt security, rather than directly adjusting the instrument’s amortized cost basis for the amount of the loss or any subsequent recovery, to

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be operationally feasible nor do we believe it would provide useful information to financial statement users.

As discussed in our response to the questions below, we believe the current impairment model for debt securities under US GAAP, together with its measurement and presentation requirements, is more appropriate and less complex. Should the Boards still decide to promulgate the allowance concept for debt securities in the final standard, we recommend substantial lead time for its implementation due to operational and systems constraints.

- We recommend the Boards conduct an outreach to the preparer and user communities to further assess the operability and usefulness of the proposed model, specifically as it would apply to the insurance industry.
- Given the significance of the Financial Instruments project to the insurance industry and the multiple issues that need to be deliberated by the Boards (i.e., application to individual debt instruments, methods of measuring credit losses, application to purchased credit impaired financial assets, variable rate instruments, interest income recognition, interaction with the classification and measurement part of the project, presentation and disclosure requirements, etc.), as the Boards continue their deliberations and re-deliberations of their previous proposals and the comments received on the SD, we recommend the entire Financial Instruments standard be re-exposed by the FASB to provide its constituents with another opportunity for review and comment prior to the issuance of the comprehensive final standard.
- Further, although there is no specific mention of the effective date and there is no transition guidance specified in the SD, we recommend the Boards allow companies sufficient time to implement the final standard given its complexity and overreaching implications.

### Convergence

- As we indicated in our response to the FASB's previous proposal, *Financial Instruments*, we believe the Boards should work together to produce a single high-quality standard on the accounting for financial instruments, and we fully support the efforts by the Boards to issue converged guidance.
- However, we do not believe the proposed impairment model would achieve these goals, because the proposed joint approach is overly complex and operationally challenging to implement. Further, the Boards' two individual proposed impairment models reflect different primary objectives, which contradict the overall goal of converging on one standard.

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Our responses to certain questions raised by the Boards of importance to AIG are included in the Appendix to this letter. Thank you for the opportunity to present our views. Please do not hesitate to contact me at (212) 770-8997 if you have any questions or need clarification with respect to any matters addressed in this letter.

Very truly yours,

/s/Tom Jones  
Director and Global Head of Accounting Policy  
American International Group, Inc.

cc: Anthony Valoroso  
Vice President and Chief Accounting Officer  
American International Group, Inc.

## APPENDIX

### RESPONSES TO IASB/FASB SUPPLEMENTAL DOCUMENT QUESTIONS

#### General

**Question 1: Do you believe the proposed 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 proposed approach is significantly more complex and operationally challenging than is necessary and would produce information that is more difficult for users to understand than that produced under current standards.

An important reason for developing a new approach to accounting for impairment was the concern that reserves tend to be at their lowest level when they are most needed at the beginning of a downward-trending economic cycle. We believe this concern could be addressed in a cost effective and easily understood manner by replacing the ‘probable’ criterion for impairment recognition in ASC 310-10-35 with a ‘more likely than not’ criterion.

We believe the FASB appropriately addressed the delayed recognition of expected credit losses for financial assets other than large groups of smaller-balance homogeneous loans managed on a portfolio basis (e.g., debt securities) when it issued the guidance contained in FASB Staff Position No. 115-2/124-2 (codified in ASC 320-10-35) and we presume financial assets managed on an individual basis are not within the scope of the SD. However, we are concerned that some of the concepts of the SD will be applied to assets currently managed on an individual basis and suggest the Boards reconsider their proposals.

#### Scope – Open Portfolios

**Question 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.**

We do not believe the SD’s proposed approach would improve the accounting contained in ASC 320-10-35 or be operational for impairment of single financial assets (debt securities and large individual loans) or closed portfolios. We believe the ASC 320-10-35 impairment guidance appropriately addresses the timeliness of credit loss recognition and measurement.

The proposed model for open portfolios would not be operational for individual debt securities or individual loans held by insurance entities. We do not believe that all financial asset classes held by entities in all industries could be grouped into portfolios because this is not how they are

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managed in every case. As part of our credit risk management process, AIG's financial assets (e.g., commercial loans, mortgage- and asset-backed debt securities) are not reviewed for impairment on a collective basis, but rather on an individual basis. Such assets have unique risk profiles and other characteristics—terms, collateral structures, geographic locations and guarantee arrangements, to name a few—and are generally large in size, and therefore do not allow for a portfolio-basis impairment methodology that might be more applicable to asset groups that are smaller in size, large in number, and homogeneous in nature. Thus, the scope of the SD does not appear to reflect the process of how an insurance enterprise manages its investment portfolio, would be impractical to implement and would not improve the accounting for financial assets.

We believe accounting impairment models should reflect the risk characteristics and economics of different asset classes. Thus, we do not support a “one size fits all” approach for all assets.

Further, we do not agree with the concept that the allowance for credit losses should be attributed to individual debt securities. As we communicated in our response to the FASB's previous proposal, *Financial Instruments*, we do not believe the proposal to create an allowance for each credit-impaired debt security (rather than directly adjust the instrument's amortized cost basis for the amount of the loss or any subsequent recovery) to be operationally feasible nor do we believe it would provide useful information to financial statement users. We believe the current impairment model for debt securities under US GAAP, together with its measurement and presentation requirements, is more operational and less complex. Should the Boards decide to promulgate the allowance concept for debt securities in the final standard, we recommend substantial lead time for its implementation due to considerable operational and systems constraints.

We suggest the existing credit impairment model for debt securities within the scope of ASC 320-10-35 be retained and applied to financial assets individually evaluated for impairment, because it results in timely recognition and measurement of impairment based on adverse changes in expected cash flows or an entity's intent or requirement to sell. This model, coupled with lowering the ‘probable’ to a ‘more likely than not’ threshold for loans within the scope of ASC 310-10-35 and with the inclusion of a ‘foreseeable future’ concept at a given reporting date, would improve the current incurred-loss model for loans, allow for a uniform methodology for financial assets individually assessed for impairment and provide useful information to financial statement users on a timely basis.

However, should the Boards still proceed with the proposed notion of grouping financial assets into portfolios despite their non-homogeneous characteristics, we recommend extensive implementation guidance be provided.

Additionally, we recommend the Boards conduct an outreach to the preparer and user communities to assess further the operability and usefulness of the proposed model, specifically as it would apply to the insurance industry.

Further, given the significance of the Financial Instruments project to the insurance industry and the multiple issues that need to be deliberated by the Boards (i.e., application to individual debt instruments, methods of measuring credit losses, application to purchased credit impaired financial assets, variable rate instruments, interest income recognition, interaction with the

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classification and measurement part of the project, presentation and disclosure requirements, etc.), as the Boards continue their deliberations and re-deliberations of their previous financial-instrument-related proposals and the comments received on the SD, we recommend the entire draft Financial Instruments standard be re-exposed by the FASB to provide its constituents with another opportunity for review and comment prior to the issuance of the final standard.

Also, although there is no specific mention of the effective date or transition guidance in the SD, we recommend the Boards allow companies sufficient time to implement the final standard given its complexity and overreaching implications.

### **Differentiation of Credit Loss Recognition**

**Question 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?**

In our comments on the FASB’s previous proposal, *Financial Instruments*, we disagreed with a *requirement* that an individual asset be assessed with other assets to determine whether a credit impairment exists. We believe a company should be allowed to *consider* assessing such an asset together with other similar financial assets for collective impairment. With this in mind and with respect to debt securities and large individual loans we recommend the Boards revise the guidance to allow companies to use judgment in determining which method is more appropriate in measuring impairment for individually-evaluated or grouped assets. Further, the method(s) and the rationale should be disclosed in the company’s financial statement footnotes.

In addition, we do not agree with the requirement of grouping all assets across all industries between the ‘good book’ and ‘bad book.’ AIG’s assets have unique risk profiles and other characteristics—terms, collateral structures, geographic locations and guarantee arrangements, to name a few—and are generally large in size and therefore do not allow for a portfolio basis impairment methodology that might be more applicable to asset groups that are smaller in size, large in number, and homogeneous in nature. The proposed model for ‘good book’ assets in open portfolios is unduly complex, has onerous data gathering requirements, would not be operational for individual debt securities or individual loans held by insurance entities and would not provide useful information to financial statement users.

Further, we believe it is inappropriate to recognize a credit impairment loss upon origination or purchase of a financial asset, whether an individual or portfolio method for evaluating credit impairment is used, if the financial asset is performing. To do so would indicate the financial asset was not originated or purchased at fair value, which is inconsistent with the substance of the transaction and does not reflect the perspective of a market participant.

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

The proposed time-proportional basis for determining the impairment allowance appears overly complex and operationally difficult and costly to implement. Also, we do not believe this approach is an improvement over existing U.S. GAAP regarding impairment of debt securities and large individual loans and would not be easily understood by financial statement users.

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

We do not believe the proposed approach is an improvement over existing U.S. GAAP regarding impairment of debt securities and large individual loans and would not provide useful information to financial statement users, because we do not believe this approach would be easily understood. It would require significant judgment and would lack comparability across industries and across entities. Refer to our response to Question 2 for our proposed approach.

**Question 6: Is the proposed 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?**

Refer to our response to Question 8.

**Question 7: Is the proposed 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?**

Refer to our response to Question 8.

**Question 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?**

Refer to our responses to Questions 2 and 3.

We do not agree with the requirement to group all assets across all industries into a ‘good book’ and a ‘bad book.’ The grouping of assets into books might work for certain industries (e.g., banking), but is not operational for insurance companies. We do not manage our holdings on a portfolio basis and therefore the proposed classifications would not be applicable to the individual debt securities or loans we hold. As part of our credit risk management process our financial assets (e.g., commercial loans, mortgage- and asset-backed debt securities) are not reviewed for impairment on a collective basis; rather, they are reviewed on an individual basis. Such assets have unique risk profiles and other characteristics (i.e., terms, collateral structures, geographic locations and guarantee arrangements, to name a few), they are generally large in size, and therefore do not allow for a portfolio-basis impairment approach that might be more applicable to asset groups that are smaller in size, large in number, and homogeneous in nature. Consequently, the ‘good book’/‘bad book’ approach does not reflect how an insurance enterprise manages its investment portfolio and would be impractical to implement. We do not believe the guidance on credit impairment for debt securities codified under ASC 320-10-35 is flawed and it should not be replaced with the proposed new approach. Therefore, we suggest the Boards amend the SD to conform to the existing impairment guidance for debt securities, under which adverse changes in expected cash flows result in periodic credit impairment loss recognition and such losses are not recognized upon origination or purchase. This, combined with lowering of the ‘probable’ to ‘more likely than not’ threshold for the impairment of loans and with the inclusion of a ‘foreseeable future’ concept at a given reporting date, would improve the current incurred-loss model for loans, allow for a uniform methodology for financial assets individually assessed for impairment and provide useful information to financial statement users.

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### **Minimum Impairment Allowance Amount**

**Question 9: The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this proposed 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?**

Refer to our response to Question 8. We do not agree with the requirement to group all assets across all industries between the ‘good book’ and ‘bad book.’ Further, we do not agree with a proposed minimum allowance amount for performing assets or for assets where there are no adverse changes in expected cash flows. However, we agree with the FASB’s proposed approach of recognizing losses expected to occur in the foreseeable future, without specifying a minimum period, at a given reporting date.

Should the Boards carry forward their joint proposal on the floor to the final standard, we recommend that bright lines should not be carried forward to the final standard. The foreseeable future should be assessed based on the facts and circumstances pertinent to an asset class at a particular point in time. Implementation guidance or broad parameters should be provided in terms of what period the foreseeable future should represent to enhance comparability and to avoid any competitive disadvantages across industries/countries.

**(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?**

Refer to our response to Question 8. Further, we do not agree with a requirement to recognize a minimum impairment loss for performing assets or for assets where there are no adverse changes in expected cash flows. The approach we propose in this letter would result in an improvement to the current incurred-loss model for loans and eliminate the need for an arbitrary floor.

**(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?**

Refer to our responses to Questions 9(a) and (b).

**(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 agree that the foreseeable future period could change due to changes in economic conditions. It could also be different depending on an asset class, geographical location and other variables.

**(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.**

Refer to our responses to Questions 9 (a) and (d). We agree that bright lines should not be established. For example, for structured debt securities, that period would likely be over the life

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of the transaction while for mortgage loans it might be difficult to estimate expected losses much beyond twelve months.

**(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.**

We believe the foreseeable future would vary by asset class and facts and circumstances existing at the date of assessment. Further, we believe implementation guidance or broad parameters should be provided in terms of what period the foreseeable future should represent to enhance comparability and to avoid any competitive disadvantages across industries/countries. As stated in our response to Question 9 (a), we do not generally agree with any bright line rules, because they are likely to be arbitrary. However, we would support the recognition in the final standard that estimates of future events become less reliable further in the future.

**Question 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.**

Refer to our responses to Questions 9 (a), 9 (b) and 9 (c).

#### **Flexibility Related to Using Discounted Amounts**

**Question 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 proposed 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?**

We do not agree with the flexibility in allowing discounted or undiscounted methods in determining lifetime expected losses, nor do we agree with the flexibility in determining the discount rate, because these proposals could lead to lack of consistency within each entity’s filings as well as negatively impact comparability between entities/industries. Further, we are concerned with the fact that this part of the proposal has not yet been deliberated by the FASB. Should the FASB reach different conclusions on the impairment measurement, the convergence goal would not be achieved by the Boards. We are also aware that the issue of discounting as it pertains to the insurance contracts accounting is currently being addressed by the Boards. Therefore, we recommend that a consistent approach on discounting and applicable interest rate is proposed by the Boards for both the insurance contracts and the financial instruments projects.

#### **Approaches Developed by the IASB and FASB Separately**

**Question 12: Would you prefer the IASB’s approach for open portfolios of financial assets measured at amortized cost to the common proposal in this document? Why or why not? If**

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**you would not prefer this specific approach, do you prefer the general concept of the IASB's approach (i.e., to recognize expected credit losses over the life of the assets)? Why or why not?**

We do not agree with the IASB proposed approach for open portfolios of financial assets measured at amortized cost for the reasons expressed in our responses above. Rather, we support a model as described in our responses to questions above and in the summary portion of this letter.

**Question 13: Would you prefer the FASB's 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 approach, do you prefer the general concept of the FASB's approach (i.e., to recognize currently credit losses expected to occur in the foreseeable future)? Why or why not?**

We agree with the general concept in the FASB proposed approach of recognizing losses expected to occur in the foreseeable future, without specifying a minimum period, at a given reporting date. However, we do not agree that an allowance amount should be recognized for all performing assets. We do not believe it is appropriate to recognize a credit impairment loss upon origination or purchase of a financial asset, whether an individual or portfolio method for evaluating credit impairment is used. To do so would indicate the financial asset was not originated or purchased at fair value, which is inconsistent with the substance of the transaction and does not reflect the perspective of a market participant. Rather, we support the model as described in our responses to questions above and in the summary portion of this letter.