# AMERICAN INTERNATIONAL GROUP, INC.



September 25, 2012

Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: FASB File Reference No. 2012-200, Proposed Accounting Standards Update, Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risk

American International Group, Inc. ("AIG") appreciates the opportunity to comment on Proposed Accounting Standards Update, *Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risk* ("Proposed ASU" or "Proposal"). A summary of our most significant observations regarding the Proposal follows. Refer to our complete responses in the Appendix for our supporting rationale.

### Scope

The Proposed ASU defines a financial institution to include an entity or reportable segment whose primary business activity is to provide insurance. We do not believe all insurance business activities should be within the scope of the Proposal. Specifically, if a reportable segment's primary business activity is, for example, property and casualty ("P&C") or mortgage guaranty insurance underwriting, we believe such segment should be excluded from the definition because the proposed liquidity risk and interest rate risk disclosures would not faithfully represent the P&C or mortgage guarantee insurance business models, which are not spread-based models, and are not representative of the way such businesses manage liquidity and interest rate risks. Both the P&C and mortgage guarantee business models focus on funding insurance liabilities under short-duration contracts with funds obtained from premiums, investment income, and the sale of highly-liquid short- and in some cases long-term investments. In addition, most of these liabilities are not discounted and do not carry contractual interest rates. While certain of these liabilities may be long-tailed, P&C and mortgage guaranty insurers generally do not attempt to specifically match such liabilities with maturing assets. As a result, we do not believe these disclosures would be meaningful to financial statement users.

# Static versus dynamic asset/liability management ("ALM")

We are concerned the proposed tabular disclosure about liquidity gap maturity does not align with the way an insurance entity manages its liquidity risk. That is, our ALM is a highly dynamic

process. Our insurance segments' financial assets generally are very liquid, consisting largely of investment-grade fixed maturity investments – thus, if there were a liquidity gap for any given period, we could liquidate such assets to satisfy the liability maturities, barring significant market dislocation events. However, the proposed tabular disclosure does not faithfully present management's ability to take rapid ALM actions to address changing circumstances. Rather, the proposed tabular disclosure presents a static view of *expected maturities* (as defined), which we believe is not representative of the true liquidity exposure of an insurance entity. Further, the proposed tabular disclosure omits significant cash inflows from premiums and investment income and operating and collateral-related cash outflows that are important to an insurance company's ALM.

#### **Decision-useful information**

We understand the proposed disclosures are intended to provide users of financial statements with additional decision-useful information about an entity's liquidity and interest rate risks. However, the Proposal will be costly to implement and, in general, we question the incremental value the users will receive with respect to insurance companies—particularly P&C insurance companies—from such extensive disclosures, which they cannot already obtain from other sources such as MD&A and statutory filings.

We understand from our Investor Relations department that analysts and investors have not expressed a strong interest for liquidity analyses at the level of disaggregation (i.e., by class of financial instrument) as would be required by the Proposed ASU. Further, it is unclear how securities analysts could interpret the liquidity gap maturity analysis and interest rate repricing gap tabular disclosures, as proposed. Both present a single static scenario based on balance sheet carrying amounts at a reporting date without considering significant other relevant cash flows (e.g., premiums) and the dynamic ALM employed by management. Therefore, we believe the proposed disclosures would present an inaccurate view about an entity's liquidity and interest rate risks. As a result, the proposed disclosures will require significant supplemental narrative disclosures to explain them properly to financial statement users. While we acknowledge comparability may be reduced, we suggest issuers be permitted the flexibility to provide information at a level that, based on their experience, is useful to users of their financial statements and reflective of the way companies manage their liquidity and interest rate risks.

#### **Interim period reporting**

The proposed disclosures would apply to annual and interim reporting periods. We believe the proposed disclosures should not be applicable to interim periods; instead, any quantitative disclosures required by a final standard should be made on an annual basis, updated with qualitative disclosures quarterly as needed based on management's judgment. Further, we believe disclosing liquidity and interest-rate-repricing risks each quarter for one year following the balance sheet date will not result in useful information to financial statement users. We do not believe the expected maturities of the majority of our financial assets and financial liabilities change significantly from quarter to quarter. Further, because most of our variable rate securities are contractually repriced to LIBOR, we do not believe, barring significant economic events, the rate fluctuates so materially that it warrants repricing gap disclosures by quarter for the next

twelve months. Also, presenting carrying amounts by expected maturities and based on the contractual repricing separately for the next four quarters would be operationally challenging for both structured securities and insurance liabilities because they lack contractual maturity and repricing dates. We do not collect such data quarterly and at such a detailed level and the proposed disclosure will therefore require significant operational effort and subjectivity to map the undiscounted cash flows maintained in various sub-systems to the fair values (for structured securities) and the discounted cash flow amounts (for certain insurance liabilities). Finally, we believe the going concern concept and management's responsibilities to make disclosures about going concern matters, when present, are sufficient to provide financial statement users with assurances about a company's important liquidity risks during the twelve months following the balance sheet date.

#### Disclosure framework

The prescriptive nature of the proposed disclosures runs counter to the key premises of the FASB's Invitation to Comment ("ITC"), *Disclosure Framework*, which focuses on flexible disclosure requirements that would allow reporting entities more judgment and discretion pertaining to the nature and extent of disclosures relevant to their specific circumstances. Further, regarding the framework for disclosure requirements for interim periods, the ITC appears to indicate that such disclosures should be built on the premise that interim periods are an integral part of an annual period and their purpose is to provide an update of significant changes from the prior-year annual financial statements. While we recognize this project is just beginning, we suggest the FASB consider the proposed disclosure requirements in the Proposed ASU in light of the concerns expressed by preparers and users of financial statements regarding disclosure overload and the research it has completed to date on this project.

### **Effective date and transition**

Although the Proposed ASU does not specify an effective date, we recommend the Board allow companies a period of at least twelve months from its date of issuance to implement a final standard. We believe implementing the Proposed ASU will pose many interpretive and operational challenges given its inherent complexity and forward-looking nature. The inherent operational complexity will be compounded for AIG and, we believe, other companies, because the proposed liquidity and interest rate risk disclosures are not based on how we manage such risks. Consequently, we will have to develop systems and procedures solely to comply with the proposed disclosures, which will not be used internally to manage such risks or to comply with existing regulatory reporting requirements designed to achieve certain of the same ends.

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Our responses to certain questions raised by the Board of importance to AIG are included in the Appendix to this letter. Thank you for the opportunity to present our views. Please contact me at (212) 770-4816 or Tom Jones at (212) 770-8997 if you have any questions.

Very truly yours,

/s/

Jeff Meshberg

Chief Accounting Officer and Global Head of Accounting Policy American International Group, Inc.

cc: Jeffrey M. Farber

Senior Vice President and Deputy Chief Financial Officer American International Group, Inc.

Tom Jones Head of Corporate Accounting Policy American International Group, Inc.

# **APPENDIX**

## RESPONSES TO FASB QUESTIONS ON PROPOSED ASU

## **Liquidity Risk Disclosures**

Question 1: For a financial institution, the proposed amendments would require a liquidity gap table that includes the expected maturities of an entity's financial assets and financial liabilities. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

We have numerous conceptual and operational concerns about complying with this requirement. Our P&C insurance reportable segment does not perform the liquidity gap maturity analysis that would be required under the Proposal. While certain of our P&C insurance liabilities may be long-tailed, we generally do not attempt to specifically match such liabilities with maturing assets. We settle the majority of our P&C liabilities under short-duration contracts either from funds generated by our operations (i.e., current premiums, investment income, etc.) or from highly-liquid short-term financial instruments. For those P&C insurance liabilities not typically settled within one year (e.g., workers' compensation, excess casualty, environmental, asbestos, or incurred-but-not-reported liabilities) the expected-maturity projections required under the Proposed ASU will be based on subjective projections of historical experience and could differ, possibly materially, from the actual timing of cash flows. While P&C companies may project cash flows as part of setting insurance reserves, we believe providing such projections in audited financial statements could suggest a level of certainty that does not exist, as can be seen in the loss reserve development tables provided in insurance companies' Form 10-Ks. P&C companies do not necessarily project cash flows to satisfy the claims; rather, the focus of the liquidity analysis is on highly-liquid short-term securities and not on the matching of expected maturities. Further, we manage our P&C liabilities on a net basis (i.e., net of reinsurance recoverables, for which the timing of cash receipts is reasonably closely matched with the related reinsured liabilities). Consequently, we believe the liquidity gap presentation, if required for P&C companies in the final standard should be integrated and not delinked, as proposed, to present properly the cash flows related to P&C loss reserves.

In addition, we do not manage the liquidity of our life insurance and retirement services reportable segment based on the fair values of our financial assets. Rather, we manage liquidity based on contractual and/or expected cash flows from premiums, investment income, investment maturities, benefit liabilities, etc. The fair values of our financial assets may not be representative of the expected future cash flows (in many cases, the par values may be more representative because, for example, we may hold them to maturity). Further, projections of our life-insurance-and retirement-services-liability cash flows can be subjective and may differ, possibly materially, from actual cash flows.

Our insurance segments' financial assets generally are highly liquid. As a result, if there were a liquidity gap for any given period, we could liquidate them to satisfy the insurance liability payment requirements. However, the proposed disclosure does not consider management's

potential dynamic ALM actions. Rather, the proposed tabular disclosure presents a static view of *expected maturities* (as defined), which we believe is not representative of the true liquidity exposure of an insurance entity. Also, our stress analysis for our life insurance and retirement services reportable segment assumes a certain level of surrenders; however, the Proposal does not specifically mention whether policy surrenders should be incorporated in the liquidity gap maturity analysis. We suggest the FASB clarify this issue in the final standard.

The Proposed ASU is unclear about whether insurance company qualifying "separate accounts" would be included in the proposed disclosures. We suggest the FASB exclude qualifying separate account assets and related contract liabilities from the scope of the disclosures because the assets supporting the related contract liabilities are legally isolated from the general account liabilities of AIG (i.e., the contract holder is not subject to AIG default risk to the extent of the assets held in the separate account and all investment performance, net of contract fees and assessments must, as a result of contractual, statutory, or regulatory requirements be passed through to the individual contract holder). The same is true for investments in consolidated variable interest entities. That is, when the liabilities of an entity must be settled without recourse to the parent company, the assets and liabilities of the entity should be excluded from the scope of the disclosures. To require such assets and liabilities to be included in the disclosures would be misleading and would require companies to prepare liquidity gap analyses solely for purposes of the proposed disclosures. We therefore suggest the FASB specifically exclude assets and liabilities of consolidated variable interest entities from the scope of the disclosures as well.

Because we do not perform our overall ALM analysis at the granular level included in the Proposed ASU (i.e., by class of financial instrument), the Proposal would be operationally challenging to implement regarding the presentation of carrying amounts by class separately for the next four quarters for both structured securities and insurance liabilities. We do not collect such data quarterly at such a detailed level and it will therefore require significant effort to develop and align the undiscounted cash flows maintained in various sub-systems with the fair values (for structured securities) and the discounted cash flow amounts (for certain insurance liabilities). Further, the proposed liquidity gap maturity analysis requires disclosures by quarter for the following year and specified periods for subsequent years. We believe disclosing such information disaggregated by quarterly time intervals for the following year will not provide decision-useful information because it may imply a level of precision that does not exist and we therefore suggest the Board require the disclosure only by year and not by quarter.

Finally, the Proposed ASU requires reconciliation of the proposed tabular disclosures to the related amounts presented in the balance sheet. However, the classes of financial instruments presented in the proposed disclosures will not reconcile to the amounts presented in the balance sheet because the proposed disclosures apply only to certain, and not all, reportable segments. For example, investments and liabilities of our non-financial-institution businesses would not be included in the proposed disclosures. We therefore recommend the FASB not include this reconciliation requirement in the final standard.

Question 2: For an entity that is not a financial institution, the proposed amendments would require a cash flow obligations table that includes the expected maturities of an entity's obligations. Do you foresee any significant operational concerns or constraints in

complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

The proposed cash flow obligations table would require disclosure of cash flow obligations by quarter for the following year and by specified periods for subsequent years. We believe disclosing such cash flows disaggregated by quarterly time intervals for the following year will not provide decision-useful information because inherent in the going concern concept is an entity's ability to meet its obligations as they come due for a reasonable period of time and, if substantial doubt exists, to make appropriate disclosures. We therefore suggest the Board require the proposed disclosure only by year and not by quarter.

Question 3: The proposed amendments would require information about expected maturities for financial assets and financial liabilities to highlight liquidity risk. Expected maturity is the expected settlement of the instrument resulting from contractual terms (for example, call dates, put dates, maturity dates, and prepayment expectations) rather than an entity's expected timing of the sale or transfer of the instrument. Do you agree that the term expected maturity is more meaningful than the term contractual maturity in the context of the proposed liquidity risk disclosures? If not, please explain the reasons and suggest an alternative approach.

We do not agree that expected maturity, as defined in the Proposal, is more meaningful than an entity's expected timing of the sale or transfer of the instrument. For instance, not including expected sales of available-for-sale securities in the disclosures could be misleading because it would imply that such securities could be held to maturity and would not be available as a source of liquidity until such a date. Further, developing liquidity gap disclosures for financial assets by class by expected maturity will require significant effort and subjective analysis for structured securities, which do not have contractually-specified cash flows. Also, for derivatives, the proposed disclosure is not based on the instrument's expected cash flows but rather the derivative's fair value is displayed by the expected maturities of carrying amounts. Many derivatives (e.g., interest rate swaps) have a zero fair value at maturity. Thus, to present the fair value as a cash flow would be misleading. We do not view this as decision-useful information.

Question 4: The proposed amendments would require a quantitative disclosure of an entity's available liquid funds, as discussed in paragraphs 825-10-50-23S through 50-23V. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

The Proposed ASU would require disclosure of available liquid funds for financial institutionand, separately, for non-financial-institution reportable segments. However, available liquid funds within a reportable segment may not be available to other reportable segments, subsidiaries, or the parent company; that is, the available liquid funds may be "trapped" within a reportable segment. Consequently, we believe the proposed disclosure might not provide decision-useful information and could be misleading, despite the proposed requirement to include a narrative discussion about the effect of regulatory, tax, legal, repatriation, and other conditions that could limit the transferability of funds among entities. Further, for the purposes of

the disclosure required by paragraphs 825-10-50-23S through 50-23U, the term *high quality* generally refers to the level of nonperformance risk associated with fixed income financial instruments. Considering this proposed guidance as well as the relevant disclosure example provided in the Proposal, it appears only debt securities would qualify as high quality liquid assets. We believe excluding unencumbered liquid equity securities from the disclosure will limit the decision usefulness of the information and recommend such securities be included in this disclosure.

Question 6: As a preparer, do you feel that the proposed amendments would provide sufficient information for users of your financial statements to develop an understanding of your entity's exposure to liquidity risk? If not, what other information would better achieve this objective?

The proposed amendments will be costly to implement and, in general, we question the incremental value the users will receive with respect to insurance companies—particularly P&C insurance companies—from such extensive disclosures that are not already available from other sources such as MD&A and regulatory filings. We understand from our Investor Relations department that analysts and investors have not expressed a strong interest for liquidity analyses at the level of disaggregation (i.e., by class of financial instrument) as would be required by the Proposed ASU. Further, it is unclear how financial statement users could interpret the liquidity gap maturity analysis tabular disclosures, as proposed. The liquidity gap maturity analysis table presents a single static scenario based on balance sheet carrying amounts at a reporting date without considering significant other relevant cash flows (e.g., premiums) and the dynamic ALM employed by management. Therefore, we believe the proposed disclosures would present an inaccurate view about an entity's liquidity risk. As a result, the proposed disclosures will require extensive narrative to explain them properly to the user community. While we acknowledge comparability may be reduced, we suggest issuers be permitted the flexibility to provide information at a level that, based on their experience, is useful to users of their financial statements and reflective of the way companies manage their liquidity.

#### **Interest Rate Risk Disclosures**

Question 13: The interest rate risk disclosures in this proposed Update would require a repricing gap table. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

We have several conceptual and operational concerns about complying with this requirement. We do not believe the proposed disclosures are relevant for a non-interest-rate-spread business such as our P&C business. Unlike an annuity contract, there is no implicit or explicit rate of return on P&C reserves and there is no interest rate repricing risk inherent in this business. Therefore, we recommend such entities be excluded from the scope of the proposed disclosures.

Further, we do not manage interest rate risk in a manner consistent with the proposed tabular disclosure. We perform asset/liability duration analyses to monitor our interest rate risk exposure. Management's actions addressing interest rate repricing risk for our life insurance and

retirement services business are more dynamic and include product design elements, crediting rate strategies, and opportunistic investments in higher yielding financial assets, to name a few. We suggest issuers be permitted the flexibility to provide information about repricing gaps that, based on their experience and the way they manage interest rate risk, is useful to users of their financial statements.

Also, in complying with the disclosure requirements of the repricing gap table, an entity must present a financial instrument's repricing date as the earlier of the date when the interest rate contractually resets and the date the financial instrument contractually matures. In terms of presenting our life insurance and retirement services reportable segment insurance liabilities, it is unclear whether contracts with repricing features stipulated under the contract terms are subject to this disclosure. We recommend the FASB clarify this in the final standard.

The weighted-average contractual yield components of the table, in our view, present the biggest operational challenge because making this disclosure would require a significant data aggregation effort for our variable rate structured securities and insurance liabilities. Further, disclosing the weighted-average contractual yield components would not provide decision-useful information, because the contractual yield for interest bearing financial assets is not necessarily the accretable yield earned (especially for structured securities) and does not reflect the effects of hedging. Also, presenting the carrying amounts for both structured securities and insurance liabilities separately for the next four quarters based on the contractual repricing would be operationally challenging because they lack contractual repricing dates. We do not collect such data quarterly and at such a detailed level and the proposed disclosure will therefore require significant effort to map the undiscounted cash flows maintained in various sub-systems to the fair values (for structured securities) and the discounted cash flow amounts (for certain insurance liabilities). Furthermore, the proposed repricing gap analysis requires disclosures by quarter for the following year and for specified periods for subsequent years. Because most of our variable rate securities are contractually repriced to LIBOR, we do not believe, barring significant economic events, that LIBOR fluctuates so materially each quarter that it warrants disclosures by quarter for the next twelve months. Consequently, we believe disclosing such information disaggregated by quarterly time intervals for the following year will not provide decision-useful information, and we therefore suggest the Board require the disclosure by year and not by quarter.

Certain balance sheet line items (e.g., equity securities, other assets and other liabilities, etc.), as specified in the disclosure example provided in the Proposal, are required to be presented to tie the table to the balance sheet even though they are not affected by interest rate repricing. We suggest the FASB streamline the table to exclude such non-informative financial and non-financial assets and liabilities, because such disclosure would not be decision-useful. Further, the Proposed ASU requires reconciliation of the proposed tabular disclosures to the related amounts presented in the balance sheet. However, the classes of financial instruments presented in the proposed disclosures will not reconcile to the amounts presented in the balance sheet because the proposed disclosures apply only to certain, and not all, reportable segments. For example, investments and liabilities of our non-financial-institution businesses would not be included in the proposed disclosures. We therefore recommend the FASB not include this reconciliation requirement in the final standard.

The Proposed ASU would require a company to provide qualitative disclosures about the difference between the company's actual interest-rate-risk management strategies and the specified uniform quantitative tabular disclosures. We are concerned that providing quantitative disclosures about interest rate repricing gaps that are inconsistent with a company's actual interest-rate-risk management strategies could mislead users of the financial statements, despite the requirement to include narrative disclosures about the differences. We believe providing such tabular disclosures would give prominence to information that could be misleading.

Question 14: The interest rate risk disclosures in this proposed Update would include a sensitivity analysis of net income and shareholders' equity. Do you foresee any significant operational concerns or constraints in determining the effect of changes in interest rates on net income and shareholders' equity? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

We believe this is a generally useful disclosure. However, it will require a significant data aggregation effort, especially for our life insurance liabilities, because management currently does not monitor the shifts in interest rate curves for each contract by the periods proposed and we generally do not maintain such level of detail for duration or convexity of the liabilities.

The Proposed ASU requires tabular disclosure of interest rate sensitivity to potential effects of shifts in the yield curve on entity's financial instruments and "hypothetical yield curves" are used in the disclosure example provided in the Proposal. However, it is unclear how a "hypothetical yield curve" is defined in the Proposed ASU. For example, in our MD&A disclosures we provide certain information about interest-rate-sensitive assets using LIBOR for floating-rate assets, government interest-rate curves for fixed-rate assets and, in general, we use a risk-free rate (10-year Treasury yield curve) for our life insurance and retirement services reportable segment insurance liabilities. We suggest the FASB clarify its intent about the meaning of a hypothetical yield curve. We believe permitting companies to determine the most relevant curves, together with providing an appropriate description of the curves used, would provide the most meaningful information for financial statement users.

Additionally, we believe the disclosure should not mandate interest-rate shifts in predefined increments. For instance, in the current low interest rate environment we do not believe it would be informative to present downward shifts in interest rates by the specified increments because doing so would not provide meaningful information. Management should be permitted to use judgment to provide the most meaningful information based on the company's unique circumstances. We also believe the Board should clarify whether equity securities and any other asset and liability accounts (e.g., deferred policy acquisition costs, shadow losses, shadow deferred policy acquisition costs, and premium deficiency reserves) that are indirectly affected by interest rate movements should be part of this disclosure. We recommend only interest bearing financial assets and liabilities be included, otherwise the disclosure could become too subjective and misleading. Further, we believe if the Board wants consistency in these disclosures the parameters used should be more specific – for example, we believe prepayment risk, which may be directly affected by changes in interest rates, should be part of this analysis

but default risk should not because it only is indirectly related to changes in interest rates, however, the Proposal does not explicitly state that.

To make the disclosures more meaningful and representative of the entire company's sensitivity to interest rate movements, we believe they should be applied to the non-financial institution reportable segments that hold interest-rate-sensitive financial instruments in addition to the entity's financial-institution reportable segments.

Question 15: As a preparer, do you feel that the proposed amendments would provide sufficient information for users of your financial statements to understand your entity's exposure to interest rate risk? If not, what other information would better achieve this objective?

Refer to our responses to questions 13 and 14.

## **Effective Date and Implementation**

Question 21: Although the proposed amendments do not have an effective date, the Board intends to address the needs of users of financial statements for more information about liquidity risk and interest rate risk. Therefore, the Board will strive to make these proposed amendments effective on a timely basis. How much time do you think stakeholders would require to prepare for and implement the amendments in this proposed Update? Are there specific amendments that would require more time to implement than others? If so, please identify which ones and explain why.

We recommend the Board allow companies a period of at least twelve months from the date of issuance to implement a final standard. We believe implementing the Proposed ASU will pose many interpretive and operational challenges given its inherent complexity and forward-looking nature. The inherent operational complexity will be compounded for AIG and, we believe, other companies, because the proposed liquidity and interest rate risk disclosures are not based on how we manage such risks. As a consequence, we will have to develop systems and procedures solely to comply with the proposed disclosures, which will not be used internally to manage such risks or to comply with existing regulatory reporting requirements designed to achieve certain of the same ends.

Question 22: Do you believe that any of the amendments in this proposed Update provide information that overlaps with the SEC's current disclosure requirements for public companies without providing incremental information? If yes, please identify which proposed amendments you believe overlap and discuss whether you believe that the costs in implementing the potentially overlapping amendments outweigh their benefits? Please explain why.

Both the proposed cash flow obligations and the available liquid funds tabular disclosures appear to overlap somewhat with the disclosures already provided under the SEC's MD&A requirements concerning an entity's liquidity, capital resources, and contractual obligations. Further, refer to our responses to questions 2 and 4 for our views on these proposed disclosures.