October 25, 2013

Technical Director
File Reference No. 2013-290
FASB
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Via email: director@fasb.org

Re: Proposed Accounting Standards Update, Insurance Contracts (Topic 834)

Dear Technical Director:

State Street Corporation (State Street) appreciates the opportunity to comment on the Financial Accounting Standards Board’s Proposed Accounting Standards Update, Insurance Contracts (Topic 834) (Proposed ASU). With $26.0 trillion in assets under custody and administration, and $2.2 trillion in assets under management as of September 30, 2013, State Street is a leading financial services provider serving some of the world’s most sophisticated institutions. As a “Systemically Important Financial Institution” and a “Global Systemically Important Bank” as designated by the Financial Stability Board and the Basel Committee on Banking Supervision, State Street plays a key role in the global financial market infrastructure.

We acknowledge and support the efforts of the Financial Accounting Standards Board (FASB, or the Board) to establish an improved financial reporting model for insurance contracts. However, as we outline in our letter, we do not support the Proposed ASU in its current form, as we do not believe it satisfies the objective of providing financial statement users with more decision-useful information about an entity’s insurance risk exposures, but rather results in financial reporting misaligned with an entity’s business model, reduced comparability, and is inconsistent with the underlying economics of a transaction. Further, we believe the insurance accounting model outlined in the Proposed ASU will be costly to implement and maintain, without any corresponding improvement to the quality of an entity’s financial statements which would reflect certain well known financial risks as insurance risk exposures.

We therefore have offered some comments in response to selected questions raised in the Proposed ASU that propose changes we believe necessary to achieve the proper balance between simplifying and improving the accounting for insurance contracts, while providing financial statement users more relevant and reliable information to evaluate an entity’s insurance risk exposures.
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In summary:

- We believe the scope of the Proposed ASU is too broad and inappropriately captures contracts that result in the recognition of a new asset (as opposed to a salvage asset or an insurance loss), contracts with insignificant insurance risk, and contracts with a risk profile more closely associated with financial risk (rather than insurance risk).
- We do not agree with the unbundling requirements as currently prescribed in the Proposed ASU. We believe that the significance of the components should be considered before a contract is classified as an insurance contract and its individual components are required to be unbundled. We also believe that companies should have the option of electing to fair value an entire insurance contract in lieu of unbundling the insurance contract into multiple components.
- We do not agree with the one-year bright line for applying the premium allocation approach, and recommend the Board adopt a more principles-based approach for determining whether an insurance contract is short duration and the premium allocation approach should be applied.
- Financial statement footnotes are an integral part of the financial statements, and we encourage the Board to strike the right balance between expanding the financial statements and footnotes, and enhancing footnote disclosures. We are concerned about the recent trend in expanding footnote disclosures, which is gradually leading to disclosure overload. The Proposed ASU contains nine pages of footnote disclosure requirements, many of which will be burdensome to produce without increasing the decision-usefulness of financial reporting.
- Operationally, the Proposed ASU will be burdensome to implement, as several aspects of the proposal would require extensive system and process changes, which will require a considerable amount of lead time to be designed and implemented, and which previously would not have been subjected to audit or financial reporting controls. In particular, as a noninsurance company, we do not have existing accounting and valuation models that can be modified to align with the Proposed ASU. As such, we believe the Proposed ASU will be costly to implement.

Following are our detailed responses to selected questions raised in the Proposed ASU:

**Scope**

**Question 1:**

Do you agree with the scope and scope exceptions of this proposed guidance, including its applicability to contracts written by noninsurance entities? If not, what types of contracts or transactions also should be included or excluded from the scope and why?

No, we do not agree with the scope and scope exceptions of the Proposed ASU, including its applicability to contracts written by noninsurance entities. We believe the scope of the Proposed ASU, and in particular its definition of insurance contract\(^1\) and insurance risk,\(^2\) is too broad and inappropriately captures contracts that

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\(^1\) **Insurance Contract:** A contract under which one party (the issuing entity) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or its designated beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder. (Glossary)

\(^2\) **Insurance Risk:** The risk, related to an insurance contract, that an uncertain future event will occur. (Glossary)
result in the recognition of a new asset as opposed to a salvage asset or an insurance loss, contracts with insignificant insurance risk, and contracts with a risk profile more closely aligned with financial risk than underwriting risk.4

Asset Recognition

Certain guarantees identified in “Example 4” of the Proposed ASU, such as standby letters of credit, lines of credit or liquidity facilities, lead to the recognition of new financial assets, as opposed to the recognition of a loss or salvage asset, highlighting that these products are designed to provide counterparty liquidity, rather than cover counterparty losses, and therefore should not be viewed as insurance contracts.

For example, if a borrower draws on a liquidity facility, direct pay letter of credit, or standby letter of credit, the lending financial institution records a new financial asset (a financing receivable) with specified payment terms and interest rate, and the counterparty is obligated to pay down that borrowing. The lending institution does not record a loss on a draw, as no loss has been incurred. Furthermore, the new financial asset does not represent salvage or claim reimbursement, since the financing receivable is a new asset and not a recovery from the sale of property covered under an insurance policy. Once a liquidity facility or letter of credit is drawn, the lending financial institution’s loss exposure stems from non-payment of that financial asset, which would be accounted for pursuant to the credit loss guidance governing that particular financial asset. Furthermore, we note that many of these arrangements, such as direct pay letters of credit, are designed to be regularly drawn-down (and subsequently repaid) in the normal course of business, as their business purpose is to provide temporary liquidity.

Therefore, we recommend that transactions resulting in the establishment of a new financial asset which must be repaid by a borrower, or an arrangement in which a claim settlement results in a simultaneous and unavoidable transaction with the party that created or experienced the loss event, would not be deemed an insurance contract and should be scoped out of the Proposed ASU, either through an explicit scope exception for these products or through a modification of the insurance contract definition. Loss recognition on such borrowings is already appropriately captured by existing financial instrument impairment guidance.

Significant Insurance Risk

The Proposed ASU defines an insurance contract as an arrangement whereby one party accepts “significant” insurance risk from another party. While we agree that an insurance accounting model should apply to contracts containing “significant” insurance risk, we note that the application of the provisions of the Proposed ASU fails to take the significance of insurance risk into consideration. Specifically, the Proposed ASU states the following:

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2 Insurance Risk: The risk arising from uncertainties about underwriting risk as opposed to financial risk. Insurance risk is fortuitous; the possibility of adverse events occurring is outside the control of the insured. (Glossary)

3 Financial Risk: The risk of possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable. (Glossary)

4 Underwriting Risk: The risk arising from uncertainties about the amount of net cash flows from premiums, commissions, claims, and claim settlement expenses paid under a contract. (Glossary)

5 Salvage: The amount received by an entity from the sale of property (usually damaged) on which the entity has paid a claim to the policyholder and has obtained title to the property. (Glossary)
Existence of one scenario in which the present value of the cash flows expected to be paid by the entity can significantly exceed the present value of the premiums and other cash inflows will be considered to satisfy the existence of significant insurance risk. That condition can be met even if the insured event is extremely unlikely or even if the expected (that is, probability weighted) present value of the contingent cash flows is a small proportion of the expected present value of all of the remaining cash flows from the insurance contract. (834-10-55-9)

We disagree with this guidance, as we do not believe that the simple existence of one extremely unlikely event should cause a contract to be considered an insurance contract subject to a complex insurance accounting framework, particularly for noninsurance entities. We are concerned that this may cause a contractual arrangement to be classified as insurance in situations where the business model or business purpose for entering into that arrangement is for a completely different (i.e., noninsurance) purpose, and the insurance-like provisions of that arrangement are incidental. Indemnification language may be customarily included in certain contracts, but the insurance protection is an outcome of the arrangement, rather than a primary motivation for entering into the arrangement. Said differently, the contract may not have been executed to provide insurance protection, but rather for a completely different business purpose.

For example, on behalf of our clients, we lend their securities, as agent, to brokers and other institutions. In most circumstances, we indemnify our clients for the fair market value of those securities against a failure of the borrower to return such securities. We require the borrowers to maintain collateral in an amount equal to or in excess of 100% of the fair market value of the securities borrowed. The collateral held by us as agent is invested on behalf of our clients. In certain cases, the collateral is invested in third-party repurchase agreements, for which we indemnify the client against loss of the principal invested. We require the counterparty to the indemnified repurchase agreement to provide collateral in an amount equal to or in excess of 100% of the amount of the repurchase obligation. The business purpose of these arrangements is to provide a secured financing product to our clients, and not to provide insurance protection. As these arrangements are fully collateralized, and the collateral is valued daily to determine if additional collateral is necessary, our experience indicates that the risk of loss is rare. Under current accounting rules, our exposure under these indemnifications are appropriately reflected in our financial statements, whereby we provide disclosure in our footnotes regarding the existence of these indemnities, and in the unlikely event we need to make a payment under an indemnification, we would accrue a loss for that exposure if the collateral were insufficient. This results in timely loss recognition by recording the loss in the period in which it arises and has been incurred.

We support an accounting framework that considers product design and the intended business objective, while considering the significance of the features being accounted for. A remote insurance-like feature in a noninsurance contract should not cause that contract to be subjected to a complicated insurance accounting model that results in an undue burden for financial statement preparers, while reducing the decision-usefulness of financial reporting. In the unlikely event a loss manifests, we believe the existing guidance for loss contingencies provides a more easily understood (and easier to apply) accounting model for loss recognition. This would align with the intended objective of the Proposed ASU in applying an insurance
accounting framework to contracts that involve the transfer of significant insurance risk, and would avoid an accounting model impacted by remote scenarios unlikely to occur or attributable to insignificant features.

Financial Risk

We believe the definition of “insurance risk” should be refined to exclude risk exposures more commonly associated with (and understood by financial statement users as) “financial risk.” We recognize that the Board considers nonperformance risk to be more aligned with underwriting risk than financial risk, however we note that credit ratings (which are included in the definition of financial risk) reflect the risk of nonperformance on a financial asset (i.e., counterparty payment default). Said differently, nonperformance or default risk is inherent in the concept of credit rating or credit quality, since an entity’s credit rating reflects the evaluation of its ability to repay its debts and its likelihood of payment default. We therefore recommend that the definition of financial risk be expanded to include the risk of nonpayment or failed transfer of a financial asset. We believe that nonpayment of a financial instrument is more appropriately captured under the credit loss guidance for financial assets, rather than under an insurance accounting model. This would provide more decision-useful information to financial statement users who understand credit risk to represent the likelihood of payment default.

Recognition

Question 2:

Do you agree with the requirements included in this proposed Update for when noninsurance components of an insurance contract, including embedded derivatives, distinct investment components, and distinct performance obligations to provide goods or services, should be separately accounted for under other applicable Topics? If not, why?

No, we do not agree with the unbundling requirements as currently prescribed in the Proposed ASU. As we noted in our response to Question 1, we believe that the significance of the components should be considered before a contract is classified as an insurance contract and its individual components are required to be unbundled. If the Board decides to retain the unbundling requirements, we recommend the Board provide the option to fair value an entire contract as a practical expedient. Furthermore, there may be certain situations where an investor may hold an instrument for trading purposes, and reporting that instrument at fair value would better reflect the business purposes for acquiring or holding that instrument.

Measurement Approaches

Question 6:

Do you agree that entities should be required to apply the premium allocation approach if the coverage period of the insurance contract, considering the contract boundary guidance, is one year or less? If not, what would you recommend and why?
We do not agree with the proposed one-year bright line for applying the PAA, and we believe its application should be an election rather than a requirement. Similar to the current accounting definition of short-duration insurance contracts, we support a more principles-based approach whereby the PAA model can be applied to all contracts that provide insurance protection for a fixed period of short duration, or whereby the contract enables the insurer to cancel the contract or revise the provisions of the contract upon renewal. We note that the International Accounting Standards Board (IASB), in its 2010 *Insurance Contracts* Exposure Draft, initially proposed that the PAA would be required for contracts that had a coverage period of approximately one year or less; however, based on constituent feedback, the IASB concluded that this would result in different accounting for similar products because there would be an arbitrary distinction for determining which contracts are eligible for the PAA based on time, and that the PAA should be optional rather than a requirement. We encourage the Board to adopt a similar approach.

**Disclosure**

**Question 41:**

Do you agree with the disclosure requirements included in this proposed Update? If not, which disclosure requirement(s) would you change and why? Are there any additional disclosures that would provide decision-useful information and why? Do you think that any of the disclosure requirements included in this proposed Update would not provide decision-useful information and should not be required? If so, which ones and why?

Financial statement footnotes are an integral part of the financial statements, and if the Board wants to provide valuable information to financial statement users, we encourage the Board to strike the right balance between expanding the financial statements and enhancing footnote disclosures. We are concerned about the recent trend in expanding footnote disclosures, which gradually is leading to disclosure overload. The Proposed ASU contains nine pages of footnote disclosure requirements, many of which will be burdensome to produce without increasing the decision-usefulness of financial reporting.

In particular, the extensive risk and sensitivity analysis disclosures proposed are onerous and better suited for Management’s Discussion & Analysis (MD&A) section of the Form 10-K and Form 10-Q filings with the United States Securities and Exchange Commission (SEC), as this information is hypothetical, forward-looking, subjective and difficult to audit. Specifically, the objective of the MD&A section, as outlined in SEC Regulation S-K Item 303, is to provide financial statement users with both a short and long-term analysis of the business of the company, which includes an evaluation of potential future outcomes.

Finally, as we noted in our November 27, 2012 comment letter to the Board on its *Disclosure Framework* Discussion Paper, the disclosure requirements in the FASB’s Accounting Standards Codification have accumulated on a project-by-project basis over many years, without significant integration. The complexity of the underlying accounting standards, the volume of associated disclosures, and the general apprehension with removing disclosures once they have been provided as well as a lack of integration in practice of accounting topics across notes, have all contributed to disclosure overload. As a result, companies have been conflicted with balancing the effective communication of information that they deem most relevant and important to investors and other stakeholders with the volume of disclosure required. We support the
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development of an overall disclosure framework that considers the reduction of the overall volume of disclosures with an emphasis on the relevance of disclosures to the users of financial statements.

Effective Date and Transition

Question 42:
The Board will establish the effective date of the requirements when it issues the final amendments. However, the Board is interested in determining the key drivers affecting the timing of implementation. What are those key drivers? How do those drivers affect the time it will take to implement this proposed guidance?

Operationally, the Proposed ASU will be burdensome to implement, as several aspects of the proposal would require extensive system and process changes, which will require a considerable amount of lead time to be designed and implemented, and which previously would not have been subjected to audit or financial reporting controls. In particular, as a noninsurance company, we do not have existing accounting and valuation models that can be easily modified to align with the Proposed ASU. For example, we would need to develop a probability-weighted expected cash flow model to value our insurance contracts, with limited data availability. Also, the guidance on determining the discount rate and subsequent accretion is quite complicated and will be challenging to implement, and the Board may wish to consider whether a risk-free rate could be used as a practical expedient. Furthermore, the retrospective adoption method in the Proposed ASU would be costly and time-consuming to implement, since information from earlier years may not be easily available.

If the Proposed ASU becomes effective, we would need a significant amount of lead time to identify and evaluate the population of contracts impacted by the Proposed ASU. We have hundreds of thousands of contractual arrangements globally, and to review all contracts for insurance language, even if incidental to the contract, would be overly burdensome. We would then need to purchase and/or develop the models necessary to account for and value those contracts. We would also need to undertake an education effort, both internally and with our user community, to inform all parties about the nuances of insurance accounting as it would apply to our organization. Finally, given the challenges and limitations with a retrospective adoption, we would support a prospective adoption approach for the Proposed ASU.

Further complicating the adoption of the Proposed ASU is all the other significant accounting changes on the horizon (e.g., financial instruments, revenue recognition, leasing) that would likely become effective around the same time. While one of these proposals may be implemented within a reasonable amount of time, the combined magnitude of all these accounting changes presents a tremendous burden to financial statement preparers. In establishing an effective date for the Proposed ASU, we ask the Board to take into consideration all the other major accounting changes coming into effect in the near future. If issued, we would request an implementation timeline of at least three years for the Proposed ASU.
Costs and Complexities

Question 47:

Describe the nature of the incremental costs of adopting the guidance in this proposed Update, distinguishing between one-time costs and ongoing costs. Explain which aspects of the guidance in this proposed Update are driving those costs and include ideas to make the proposal more cost effective.

As we noted in our response to Question 46, since we are not an insurance company, we do not have the accounting and valuation infrastructure in place to easily enable us to adopt the Proposed ASU. The Proposed ASU will be costly to implement, as several aspects of the proposal would require extensive system and process modifications. Specifically, we would need to purchase and/or develop the models or systems necessary to account for and value insurance contracts. Among other changes, we would need to develop a probability-weighted expected cash flow model to value our insurance contracts, with limited data availability. Also, the guidance on determining the discount rate and subsequent accretion will be challenging to implement. Furthermore, the retrospective application method in the Proposed ASU would be costly and time-consuming to implement, since information from earlier years may not be easily available. We would also need to undertake an education effort, both internally and with our user community, to inform all parties about the nuances of insurance accounting as it would apply to our organization. Finally, appropriate controls would need to be designed, documented and tested, and these new models or systems would need to subject to audit. Therefore, it is unclear whether the benefits associated with using insurance accounting outside of the insurance industry are sufficient to overcome these costs.

We appreciate your consideration of our comments and welcome the opportunity to discuss them with you.

Sincerely,

Sean P. Newth
Senior Vice President and Director of Global Accounting Policy