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Financial Accounting Standards Board
401 Merrit 7
Norwalk, CT, 06856-5116, USA

International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH, United Kingdom

Re: Leases Exposure Draft

Dear Board Members:

Factory Mutual Insurance Company and subsidiaries (“FM Global”) welcomes the opportunity to comment on the Leases exposure draft (“ED”) issued jointly by the FASB and IASB in August 2010.

FM Global is a leading commercial and industrial property insurer of the world's largest businesses, providing more than one-third of FORTUNE 1000-size companies with engineering-based risk management and property insurance solutions. Ranked 545 on the FORTUNE 1000 list of America’s largest companies, FM Global employs more than 5,100 employees worldwide. FM Global is operating in more than 130 countries worldwide. As of December 31st, 2009, total assets and total stockholders’ equity of FM Global were US \$12.9 billion and US \$6.3 billion, respectively.

FM Global is a lessee of office space, vehicles and office equipment in the many countries in which it operates. All of its leases are currently accounted for as operating leases under current US GAAP standards.

FM Global is also a lessor of office buildings through its subsidiary, FMRE Holdings LLC. FMRE Holdings is among the 25 largest landlords of commercial office space in the greater Boston area and the second largest in the surrounding Boston area, with 2.4 million rentable square footage. The office buildings are considered investment property and are accounted for as operating leases under the current US GAAP standards.

We appreciate that the Boards are working towards important changes in the current lease accounting standards; however, we disagree with the approach, complexity and subjectivity involved in some of the requirements outlined in the exposure draft. We believe that these complexities are unnecessary, and may even result in misleading and speculative information where the estimates required are impossible to determine in a manner that is accurate and consistent among different reporting entities.

Please note that leasing is not our main source of business and the assets and liabilities that the exposure draft requires will be immaterial on our consolidated financial statements, yet the cost involved to implement and maintain the requirements as written will be substantial.

Our primary concerns are the requirements for lessees to recognize assets and liabilities where the risks and rewards of ownership are retained by the lessor, and for lessors to recognize additional assets and liabilities which are costly and complex to determine and result in little-to-no benefit to the financial statement users. Secondly, if lessees and lessors are to recognize such assets and liabilities, we are concerned with the requirement to estimate the longest possible lease term that is “more likely than not” to occur in consideration of lease options that have yet to be exercised. We believe that these options are not true liabilities and the work involved to make these determinations and to reassess them at each reporting period will be impractical to apply.

Please see the attached appendix for our specific responses and recommendations to the discussion paper questions for respondents.

We appreciate the Board’s consideration of our comments and would be happy to discuss them in more detail if needed. Please feel free to call me at 781-906-3104 at your convenience.

Sincerely,

Anthony J. Mistretta
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cc. Jeffrey Burchill, Senior VP and CFO, FM Global
Theresa Molloy, VP and Controller, FM Global
Thomas M. Dusel, VP Real Estate, FM Global

Question 1: Lessees

- (a) Do you agree that a lessee should recognize a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?
- (b) Do you agree that a lessee should recognize amortization of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

- (a) No, we disagree that an asset and liability should be recognized by the lessee in cases where the primary risks and rewards of ownership are retained by the lessor and/or are immaterial.

Our concerns are that the proposed requirements are too complex. For example, the formula used to calculate the net present value of the right-of-use asset and liability is complex in itself and would require significant understanding and system enhancements in order to support the proposed leasing standards.

To further complicate the requirements, we believe the need to capitalize all leases may impact both financial ratios and industry ratings negatively and adversely affect businesses unnecessarily.

The proposals may also affect the lessees' strategic decisions whether to enter into a long term or short term lease, or whether to buy or lease an asset. If the lessee is required to record a liability that represents the longest probable lease term based upon lease renewal options, the options may become less attractive.

Some of the variables and inputs that are required in the net present value calculations are also too subjective and should be omitted. An example would be including certain unexercised renewal options in the lease term that are based on speculative judgment (please refer to question 8 for further explanation).

Finally, the costs associated in developing systems and processes in order to comply with the proposed standard would far outweigh the benefits for our financial statement users. For example the costs to develop a process tool to determine renewal probabilities and contingent rent projections would not add much value to our financial statement users.

We recommend that leases should continue to be accounted for as operating or finance leases under the current US GAAP criteria. We feel the current guidance portrays the underlying economic substance of our leases and is sufficiently adequate in providing our consolidated financial statement users with fair and reasonable information.

- (b) No, as stated in Part (a) above, we disagree that an asset and liability should be recognized by the lessee where risks and rewards of ownership are retained by the lessor and/or are immaterial. In such cases, we believe the leases should continue to be accounted for as operating or finance leases under the current US GAAP criteria.

If the lease proposals were to require that a lessee recognize an asset and liability, we agree that the right-to-use asset should be amortized over shorter of the term of the lease or the useful life of the asset. We also agree that the lessee should separately recognize interest on the liability to make lease payments.

However, we recommend that lessees be given examples either in the standard itself or the bases of conclusion document of the rate the lessor charges the lessee. For example, allowing lessees to use the rate implicit in the lease or the lessee's incremental borrowing rate in determining the present value of the right-of-use asset and the liability of all outstanding leases. Giving lessees additional guidance would allow for a more relevant and applicable rate to be used and a rate that reflects the economic substance of the underlying transaction.

We also recommend that lessees be given the option to use the straight line method when subsequently measuring the liability to make lease expenses in addition to the interest method. By giving lessees the option to choose the approach that best reflects the underlying transaction over the period of the lease, will allow for better presentation and disclosure.

Question 2: Lessors

- (a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
- (b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?
- (c) Do you agree that there should be no separate approach for lessors with leveraged leases, as is currently provided for under US GAAP (paragraph BC15)? If not, why not? What approach should be applied to those leases and why?

(a)(i) No, we disagree in concept with the performance obligation approach where the primary risks and rewards of ownership are retained by the lessor for the same reasons as described in question 1(a) above. We believe it is costly and complex and has no financial or informational benefit to our financial statement users.

In addition and on the flip side; the proposed lease accounting rules may cause a decrease in the lessors' business because of the lessees' decisions to enter into long term versus short term leases, buy versus lease or enter into lease contracts that contain renewal options. It may even contribute to a temporary slow-down in the leasing industry.

We recommend that lessors should not be subject to this requirement and that leases should continue to be accounted for as operating or finance leases under the current US GAAP criteria.

(ii) No comments.

(b) No, as stated in part (a) above, we disagree with the performance obligation approach. We recommend that lessors should not be subject to this requirement and be allowed to continue to account for such leases as operating or finance leases under the current US GAAP criteria. We believe the current guidance is sufficiently adequate in providing our consolidated financial statement users with fair and reasonable information as it portrays the economic substance of our leases.

If the performance obligation approach is however required we agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation. We still believe it will be at a significant cost with little benefit and would not add any additional insight to the activities or exposures of the company.

For similar reasons as in question 1(b) above, we also recommend that lessors be given the option to use the lessor's incremental borrowing rate when initially measuring the right to receive lease payments and the lease liability on all outstanding leases, as it is readily available. We would also recommend that lessors be given the option to use the straight line method when subsequently measuring the right to receive lease payments.

(c) No comments.

Question 3: Short-term leases

This exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is 12 months or less:

(a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in the income statement over the lease term (paragraph 64).

(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other Topics and would recognize lease payments in the income statement over the lease term (paragraph 65).

(See also paragraphs BC41–BC46.)

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

No, we do not agree with the accounting for short-term leases in either (a) and (b) above and recommend that such leases continue to be accounted for as operating or finance leases under the current US GAAP criteria. Once again we reiterate the fact that it would add significant cost and resource in order to comply with the proposed standard with little benefit to the users of financial statements. We feel the current guidance already portrays the underlying economic substance of our leases and is sufficiently adequate in providing our consolidated financial statement users with fair and reasonable information.

Definition of a lease

This exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). This exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
- (b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?
- (c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

We agree with the lease definitions. However we recommend that the Boards retain the operating and finance lease accounting principles as currently followed in US GAAP.

Scope

Question 5: Scope exclusions

This exposure draft proposes that a lessee or a lessor should apply the proposed guidance to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

Do you agree with the proposed scope of the proposed guidance? Why or why not? If not, what alternative scope would you propose and why?

No, we believe that a lessee or a lessor should continue to apply the scope currently defined under US GAAP. We recommend excluding the requirement to record an asset and liability for any operating leases as recommended in the proposed guidance.

If required to follow this new standard, we recommend adding to the scope exclusions any leases that are incidental to the companies business; for example copy machine leases in an insurance company. The new guidance relating to the copy machine leases is immaterial to the balance sheet and income statement of the insurance company and does not add any additional insight to the activities or exposures of the company.

Question 6: Contracts that contain service components and lease components

This exposure draft proposes that lessees and lessors should apply the guidance in proposed Accounting Standards Update, *Revenue Recognition* (Topic 605): *Revenue from Contracts with Customers*, to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

(a) The FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.

(b) The IASB proposes that:

(i) A lessee should apply the lease accounting requirements to the combined contract.

(ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.

(iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the guidance in the exposure draft on revenue from contracts with customers.

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

No comments.

Question 7: Purchase options

This exposure draft proposes that a lease contract should be considered terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

Measurement

This exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

(a) assumes the longest possible term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).

(b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be reliably measured.

(c) is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from

changes in the lease term or contingent payments, including expected payments under term option penalties and residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132–BC135).

We agree with this section.

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

No, we disagree with this approach because we do not believe that the unexercised options to extend or terminate the lease represent true contractual liabilities or reductions thereto.

Further, it would be difficult and impractical to estimate the probabilities of these options being exercised, especially on those lease contracts that extend many years into the future. The exercising of such options is often dependent upon economic conditions and growth or failure of enterprises that are impossible to forecast with any accuracy or consistency. The resulting estimates would be speculative at best, add little value and possibly mislead financial statement users. The large investment of time that would be required to estimate and constantly revisit these probabilities would yield little to negative benefit.

We strongly recommend that the Boards omit this proposed requirement and allow companies to account for leases using the stated lease term without considering any lease options that have not yet been exercised.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why? Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be reliably measured? Why or why not?

Yes, we agree with this approach if the contingent rentals, term option penalties and/or residual value guarantees are material and can be reasonably estimated. If the amounts are immaterial, we believe they should be disregarded. If the amounts cannot be reasonably estimated, we recommend describing and disclosing their nature in a footnote to the financial statements.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

No, as stated in our responses to questions 1 and 2 above, we disagree with the requirements for lessees and lessors to recognize additional lease assets and liabilities.

If we are however required to recognize assets and liabilities, we agree that a company should remeasure assets and liabilities arising under a lease when material changes in facts or circumstances (“triggering event”) indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period.

We do however recommend that the requirements be simplified as outlined in our response to previous questions in this letter. For example:

- Continuing to account for leases as operating or finance leases under the current US GAAP criteria,
- Eliminating the longest possible term that is more likely than not to occur concept,
- Giving the option to also use the implicit interest rate in determining the present value of the right-of-use asset and the liability of all outstanding leases.
- Allowing the use the straight line method when subsequently measuring the liability to make lease expenses.

These simplifications will enable companies to perform reassessments in a practical manner, without undue costs. Without simplification, the reassessments would be extremely burdensome and costly, and with little to negative benefit.

Sale and leaseback

This exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents a sale of the underlying asset, the leaseback also would meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

Question 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

No comments.

Presentation

This exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

Question 12: Statement of financial position

(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

- (a) Yes, we agree that lessees should present lease-related line items separately from non-lease-related line items on the statement of financial position only if they are material. If the lease-related line items are immaterial with respect to the non-lease-related line items, the lessees should have the option of grouping them together for the sake of simplicity.
- (b) Yes, we agree that lessors should present lease-related line items separately from non-lease-related line items on the statement of financial position only if they are material. If the lease-related line items are immaterial with respect to the non-lease-related line items, the lessors should have the option of grouping them together for the sake of simplicity.
- (c) We have no comments on this because we anticipate that all of our leases will be treated as performance obligations.

- (d) Yes, we agree that lessors should present sub-lease-related line items separately from primary-lease-related on the statement of financial position only if they are material. If the sub-lease-related line items are immaterial with respect to the primary-lease-related line items, the lessors should have the option of grouping them together for the sake of simplicity.

Question 13: Income statement

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in the income statement (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

Yes, we agree that lessors and lessees should present lease income and lease expense separately from other income and expense in the income statement only if they are material. If the lease income and lease expense are immaterial with respect to other income and expense, the lessors and lessees should have the option of grouping them together for the sake of simplicity.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Yes, we agree that cash flows from leases should be presented in the statement of cash flows separately from other cash flows only if they are material, that is, if the material lease-related line items have been presented separately in the statement of financial position and the statement of income, they should also be presented separately in the statement of cash flows.

Disclosure

Question 15

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognized in the financial statements arising from leases; and
- (b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows?

(paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

Yes, we agree that lessors and lessees should disclose for both (a) and (b) the quantitative and qualitative information that is significant, material, and cost effective to obtain with respect to the lease-related line items presented in the financial statements and to how leases may affect the amount, timing and uncertainty of the entity's future cash flows

Transition

Question 16

- (a) This exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

- (a) Yes, we agree with the simplified retrospective transition approach as a fair and reasonable means of implementation; however we recommend that it is permitted for any leases effective at transition to be discounted at either the incremental borrowing rate or implied rate effective at that point in time.
- (b) Yes, we agree with permitting the full retrospective transition approach.
- (c) No.

Benefits and costs

Question 17

Paragraphs BC200–BC205 set out the boards’ assessment of the costs and benefits of the proposed requirements. Do you agree with the boards’ assessment that the benefits of the proposals would outweigh the costs? Why or why not?

No, we do not agree with the boards’ assessment of the costs and benefits. We believe that the exposure draft as presently written is overly complex and will result in significant and unwarranted costs and burden to both lessors and lessees with little to no benefit to our financial statement users.

Other comments

Question 18

Do you have any other comments on the proposals?

FM Global Response:

Field testing

We believe that it is critical that the Boards perform field testing on this exposure draft to ensure that the standards will work in practice.

Non-public entities

Question 19

Should any of the proposed guidance be different for non-public entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

Yes, if the Boards determine that the requirements of the exposure draft are necessary we believe they should not apply to non-public entities, because the private companies' financial statements are not relied upon by external investors and does not add any additional insight to the material activities or exposures of the company.