

David W. Chellgren
Director, Investment Accounting
860-299-2112
David.Chellgren@Conning.com

March 24, 2011

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 Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Impairments

Dear Chairman Seidman:

Conning appreciates the opportunity to comment on the supplementary document noted above relating to Impairments. Conning does the asset management and investment accounting for over 100 small to mid-size insurers totaling over \$75 billion (over 95% of which are invested bonds).

The following are our positions relative to the questions distributed within document File Reference No. 2011-150.

Question 1 Do you believe the proposed approach for recognition of impairments described in the 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?

In general we agree with this concept, however, we prefer an approach that is more prescriptive in nature. We have concerns that under this proposal the "use of all available" information to formulate impairment losses will lead to a lack of consistency and potentially a lack of transparency. To resolve this issue we would propose an approach where the FASB provides specific guidelines based on their analysis of expected losses. Historical loss experience can be determined on investments based on studies by the major rating agencies. A process currently exists in the insurance industry today through an actuarially formulated process called Risk Based Capital.

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?

We see no reason why not.

Question 3 Do you agree that for financial assets in the "good book" it is appropriate to recognize the impairment allowance using the proposed approach described above? Why or why not?



We agree it is appropriate to recognize impairment in a time-proportional manner depending on the age and characteristics of the portfolio. However, we do have some issues with companies determining impairments expected to occur within the foreseeable future if the time period goes beyond twelve months. As the period of time extends, so does the degree of uncertainty and the ability of companies to potentially manipulate results. Therefore we propose a reserve based on long standing historical events, but have concerns about companies making accurate forecasts over the foreseeable future and the impact on the "floor".

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

If the impairment allowance could be maintained as a "general reserve" the answer is yes. However, if the reserve is expected to be maintained at the cusip or lot level this would be quite burdensome. Currently, no operating system has the ability to track and maintain incremental impairment information at a lot or cusip level. Further we feel the associated cost would exceed the benefit. What value would there be to tracking impairment reserves of de minimis amount at a lot/cusip level. For companies that invest in an investment grade portfolio, these amounts would be reversed at maturity, which should occur 99% of the time. Therefore it would be impractical to design a process that would impact the universe, when such a small segment is ultimately impacted.

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

We like the proposal for a time-proportional impairment as we agree that it is not appropriate to assume that if an investment is paying today, that it will always continue to pay. However, we do have concerns about the consistency of the application, as they apply to forecasts, within this guideline. To minimize this outcome, it would appear that increased disclosures maybe required.

Question 6 Is the proposed requirement to differentiate between the two groups (i.e. "good book" and "bad book") for the purposes of determining the impairment allowance clearly described? If not, how could it be described more clearly?

The two groups are clear and make sense. One question, however, if an asset has been performing and is in the good book, once there is an actual credit event (loss); do you now re-class the asset to the bad book? This would theoretically result in a decrease to the "good book" reserve with an offsetting increase to the "bad book" reserve. Therefore the net impact in the period of the loss would be zero. Is this the intent?

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?

Yes, it should be straight forward for companies and their auditors to determine which investments have been meeting their contractual obligation and those that have not or those that are likely not to meet their future obligations (watch list).

Question 8 Do you agree with the proposed requirement to differentiate between the two groups (i.e. "good book" and "bad book") for the purposes of determining the impairment allowance? If not, what requirement would you propose and why?

Agreed, we like a general reserve for performing assets and a specific reserve for those securities that have incurred a loss or are expected to incur a loss.



Question 9a The boards seeking comment with respect to the minimum allowance amount (floor) that would be required under the proposed model. Do you agree with the proposal to require a floor for the impairment allowance related to the "good book"? Why or why not?

The notion of a floor reserve amount is logical, however, the practicality of that maybe at issue. See question 9c below.

Question 9b Alternatively, do you believe that an entity should be required to invoke a floor for impairment allowance related to the "good book" only in circumstances in which there is evidence of an early loss pattern?

We have concerns with the use of a floor; however, if a floor has to exist it should apply only in instances of a CLEAR loss pattern that exceeds the historical trend of your time-proportional impairment amount. An example of a clear loss pattern would be in situations where the downgrade to upgrade ratio exceeds the historical average. This would occur in periods where there is a significant increase in the magnitude of downgrades or where the downgrades exceed the historical average for an extended time period. (A one year slight increase would not constitute a clear loss pattern.) Based on the Moody's study for corporate securities, the historical average would be a little more than 2:1 (downgrade to upgrade ratio). Although is this too subjective?

Question 9c 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 with the foreseeable future (and not less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance be determined?

While the notion of determining a floor amount based on a forecast of the "foreseeable future" sounds reasonable, we have concerns about the practical application of this theory? How is a company going to reasonably forecast that a segment of the marketplace is going to underperform over the next twelve to twenty-four months? If that is the case, they would probably try to sell out today and incur the loss (intent to sell impairment) in the current period. Assume we are in 2007, would you expect that companies would have foreseen the market collapse to occur in 2008. To apply a floor on a broad portfolio of investments would appear to be very subjective and possibly overly punitive (2008). Therefore any floor that is required should be based on a CLEAR loss pattern and not on a forecasted loss expected within the foreseeable future. Many companies have implemented a policy of segregating assets into a "watch list" "close watch list" or "potential problem loan list". These would be instances were companies could apply a floor adjustment. Again, our preference would be for some kind of formula driven approach that would be applied consistently, thereby improving consistency and transparency among companies.

Question 9d For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?

Yes, but this should apply to specific investments, anything more than that would be too subjective.

Questions 9e & f No further comment.

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 to be the case.



Looking at the Moody's Investors Service Corporate Default and Recovery Rates survey from February 2010 it would appear the floor would be equal to or higher in years when the downgrade – to – upgrade ratio is climbing but could be less than the time-proportional amount in years where the downgrade – to upgrade ratio is declining or unchanged. Periods of time where a declining or unchanged ratio existed occurred from 1994 – 1998 and 2004 – 2007.

It would also make sense to include a Maximum or ceiling amount for impairments. The ceiling could be tied to a percentage based on the actual losses incurred in a particularly bad year. Using the above referenced survey (Exhibit 10) on corporate securities, the maximum amount would be 2009 where there was a 3.3% default rate and depending on the type of security (Sr. Secured, Sr Unsecured, Sr Subordinated, etc) the percentage recovery rate would vary (Exhibit 21). This maximum would limit irrational actions to dramatic, unforeseen and unknown downturns that will occur. This would eliminate the potential that possibly could have occurred within the Life insurance industry if they had been required to take impairment losses anywhere near to where the market value was in 2008 (forcing some into insolvency). As history has shown, much of the decline in value was due to market illiquidity and not actual credit losses.

Question 11a The board is seeking comment with respect to the flexibility related to using discounted amounts. 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)?

Since companies would be recording the "good book" impairment on a time-proportional (matching) approach over the life of the investments it would appear that an undiscounted approach would be warranted. However, for the "bad book," the use of a discounted cash flows approach (using the current book yield, not current market yield) is reasonable for those specific assets and more closely reflects the current amount of the losses to be recognized (as is the case today under ASC 320-10-35).

Question 11b Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

For the "good book" we do not like the use of a discount rate. However, for the "bad book" we prefer the use of an "effective interest rate" (e.g. discount rate equal to the book yield for bonds) as that is the most applicable rate.

Question 12 Would you prefer the IASB approach for open portfolios of financial assets measured at amortized cost to the common approach in this document? Why or why not? If you not this specific approach, do you prefer the general concept of the IASB approach (i.e. to recognize expected credit losses over the life of the assets)? Why or why not?

We have concerns about the use of a floor based on the "foreseeable future" and feel that under the currently proposed language this would be too subjective and therefore subject to manipulation. While we can appreciate the FASB Boards desire to have a reserve that is at least equal to the expected losses, we are not convinced that the reserve always needs to be equal to the current loss. Rather the reserve should be established based on the long term expected losses and insulating companies from dramatic losses.

Question 13 Would you prefer the FASB approach for assets in the scope of this document to the common proposal in this document? Why or why not?

See the answer to question 12 above for our preferred approach.



## In summary our major points

- We like the concept of a general reserve based on longer term trends. This reserve should be a general reserve and not a cusip or lot level reserve as this would be an administrative burden.
- The best way to ensure this reserve meets the principles of consistency and transparency is for the FASB to issue formulaic guidelines based on the historical results (obtained and compiled from the major rating agencies). This guideline could be similar to the Risk Based Capital charge calculated today in the insurance industry.
- We do not like a floor level reserve based on the foreseeable future as this would be too subjective and would not be consistent with the goals of consistency and transparency. If a floor level reserve is a priority then the reserve should be more "bad book" based on an analysis of securities within the "watch list".
- We like an impairment approach that also includes a maximum (ceiling) that would serve to protect companies from adverse deviations in the market place. This would allow time, in those situations, for the "dust to settle", and avoid taking unjustifiable impairments.

Thanks for the opportunity to respond to your questions. We hope these ideas are constructive and useful. Please feel free to contact me at <a href="David.Chellgren@Conning.com">David.Chellgren@Conning.com</a> if you would like to discuss this further.

Sincerely,

David W. Chellgren

