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**Re: File Reference Number 2013-220, Exposure Draft – Proposed Accounting Standards Update, *Financial Instruments – Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities***

Dear Ms. Seidman,

As one of the leading global reinsurers, The Swiss Re Group ("Swiss Re") supports the Financial Accounting Standards Board (the "FASB" or the "Board") in developing high-quality accounting standards, as well as FASB's and IASB's joint efforts to develop consistent or converged standards with the aim to achieve financial reporting under a single set of high quality globally accepted accounting standards. Swiss Re's consolidated financial statements are prepared in accordance with the accounting principles generally accepted in the United States of America ("US GAAP"). We have reviewed the Exposure Draft, Proposed Accounting Standards Update, *Financial Instruments – Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities* (the "Exposure Draft") and welcome the opportunity to share our feedback with you.

We appreciate the FASB's efforts to provide financial statement users with more decision-useful information about an entity's investments in financial instruments and the efforts to simplify the accounting for those instruments. We agree with the principle that an entity shall classify and measure its financial assets based on the contractual cash flow characteristics and the business model in which assets are managed. However, we have concerns that the proposed recognition and measurement model may increase complexity and lower transparency and therefore decision-usefulness of the respective financial information. We therefore believe that the proposed model requires improvements in various areas.

We have the following comments about the Exposure Draft that we believe the Board should consider in its further deliberations:

**1. Interaction with the insurance contracts project**

Asset-liability management represents a key aspect of (re)insurance business where insurance liabilities, guarantees and related assets (including derivatives) are managed together. The accounting

should reflect this linkage. Accounting requirements that deal with individual components in isolation, separately from the overall asset-liability management strategy, do not adequately reflect the (re)insurance business and the related performance. We believe that changes in insurance liabilities and the financial assets backing them should be presented together: either in net income or in other comprehensive income ("OCI"). If the related changes in assets and liabilities are reported inconsistently, they will result in an accounting mismatch and performance reporting that does not provide decision-useful financial information.

We believe that the introduction of this Exposure Draft before the finalization of the proposal for insurance contracts is not consistent with the objective of creating the linkage between assets and insurance liabilities and that the two standards should be considered at the same time for (re)insurance companies. Further, we would like to note that a proper assessment of the proposal for financial instruments cannot be made without understanding the new proposal for insurance contracts given the interrelated nature of the two projects. We recommend that the Board continue to consider these interrelationships prior to finalizing both projects and allow for the alignment of the effective dates for these projects as discussed further in the comment 8 below.

## **2. Business model assessment**

We support the Board's efforts to introduce a principle of presenting financial results in accordance with a business model in order to provide more decision-useful financial information to financial statement users.

We believe the business model, and not the asset characteristics test, should be the main driver of classification and measurement. The classification and measurement in the financial statements should reflect how groups of financial assets and financial liabilities are managed together to generate economic value for an entity, rather than be determined on the basis of likely insignificant embedded features, as currently proposed. As further discussed below, we believe that the restrictions imposed by the contractual cash flow characteristics test will in some cases cause financial instruments to be classified and measured at fair value through net income ("FV-NI") in cases where such classification and measurement is inconsistent with the business model of (re)insurance companies.

We believe the Board should include an option to classify debt instruments at fair value through other comprehensive income ("FV-OCI") (the "FV-OCI Option") regardless of the contractual cash flow characteristics, for the circumstances when measuring assets at FV-OCI would reduce an accounting mismatch. There are certain instances where debt instruments supporting insurance contract liabilities may be measured at FV-NI because of the "solely payments of principal and interest" threshold test ("SPPI Test"), or at amortized cost ("AC") because of the business model test, where FV-OCI would provide asset measurement more consistent with the related liabilities. We believe that in the context of our business the "FV-OCI Option" would effectively be limited to assets backing liabilities in the scope of the insurance contracts standard where changes in the discount rate are recorded in OCI. The FV-OCI option would better align the measurement of assets and liabilities for (re)insurance companies and would provide more relevant and useful information to financial statement users.

We would not object if the above were to be accomplished for the (re)insurance industry by introducing additional industry-specific guidance that would allow for recognition and measurement of assets and liabilities consistent with asset-liability management strategy. The interaction between assets and liabilities is fundamental for (re)insurance companies' approach to managing business and reporting performance.

### **3. Contractual cash flow characteristics assessment and the proposed definition of principal**

We recommend that the Board revisit the contractual cash flow characteristics test. We believe that standard contractual features in many financial instruments may not meet the SPPI Test. We request that the Board consider replacing the SPPI Test with the existing bifurcation guidance for embedded derivatives (Topic 815) or, as an alternative, amending certain provisions of the SPPI Test to make it less restrictive, as further described below.

We are supportive of retaining the existing guidance for embedded derivatives as it is well understood in its current form and its application in the industry is consistent. We believe that retaining bifurcation of embedded derivatives represents a reasonable accommodation to ensure that the asset characteristics based assessment is performed on the individual instrument as a part of the classification and measurement assessment.

We are concerned that the restrictive nature of the SPPI Test could lead to determining classification of debt instruments based on likely insignificant embedded features. As a result, the impact to net income would not be proportional to the significance of the feature, as the proposed guidance gives little consideration to the significance of the feature in relation to the debt instrument as a whole.

We are also concerned that the proposed definition of principal, if not expanded to include the repayment of the principal amount at maturity or other settlement (e.g., a call date), could cause certain prepayable financial instruments purchased at a significant discount or premium to fail the SPPI Test solely based on the instrument's purchase price and not the actual characteristics of the instrument.

In our view, the aforementioned aspects of the Exposure Draft would inappropriately result in disqualifying the entire financial instrument from being considered solely principal and interest even though the instrument represents cash flows that are substantially payments of principal and interest.

Lastly, we are concerned that the complexity and the detailed nature of the SPPI Test may create additional restatement risk, as the preparers may be more likely to fail to initially identify non-substantive features embedded in debt instruments. This could result in inappropriate classification of the entire financial instrument. The subsequent reclassification of the entire financial instrument would have significantly greater impact to financial statements, as compared to the impact of the determinative embedded feature.

Therefore, we recommend that the Board modify the SPPI Test from "solely" payments of principal and interest to "substantially" payments of principal and interest. Such a modification would simplify the application of the model and would also reduce restatement risk and alleviate the concern that less than significant contractual features would impose classification of an entire financial instrument at FV-NI.

### **4. Beneficial interests in securitized financial assets**

We believe that it will be challenging to gather the information related to the underlying collateral pool to determine whether the SPPI Test is met and to assess the credit worthiness of those assets relative to the beneficial interest. Even if the information were easily available, we would still be concerned about feasibility and cost of evaluating the assets comprising the underlying collateral pool.

If the requirements in 825-10-55-26 (b) and (c) (i.e., the requirements to evaluate whether the contractual cash flows of the underlying pool of instruments meet the SPPI Test and whether the credit risk of the beneficial interest tranche is equal to or lower than the credit risk of the underlying pool) were to remain as proposed, we recommend narrowing the scope of the instruments that require the look-through test to the tranches that are most subordinated. This objective could be accomplished through incorporating a provision that senior beneficial interests of certain credit quality would automatically be considered to pass the SPPI Test and would only need to be evaluated under the business model assessment.

#### **5. Fair value through net income classification option (Fair Value Option)**

We are supportive of the Fair Value Option for the financial assets that qualify for the FV-OCI business model.

We believe that the ability to elect the Fair Value Option should allow for matching of assets and liabilities to facilitate financial reporting reflective of a reporting entity's business model. Carrying an asset or a liability at fair value is elected commonly when there is a measurement mismatch between assets and liabilities. Therefore, prohibiting an entity from presenting assets and liabilities on the same measurement basis will lead to financial information that is not decision-useful. As discussed in the comment 2 above, we believe that the possibility to classify both assets and insurance liabilities either at FV-OCI or FV-NI must always be available to reflect how a (re)insurance company manages assets and liabilities and presents its performance. This point will be especially relevant in light of the new proposal under the FASB's insurance contracts project where insurance liabilities are expected to be recognized through net income with certain elements potentially recognized through OCI.

For example, where portfolios of insurance contracts are backed by debt securities measured at amortized cost, or at FV-OCI, this option would be necessary to measure the respective debt securities at FV-NI to avoid mismatches. This assumes that the insurance contract project would also allow for fair value through net income option for insurance liabilities.

#### **6. Foreign currency transaction gains and losses arising on debt securities**

We strongly support the proposed amendments that would require an entity to separately recognize in net income changes in fair value attributable to foreign currency gain or loss on foreign-currency denominated debt securities measured at FV-OCI. The current rule that requires the effect of changes in foreign currency exchange rates on both the amortized cost amount and unrealized gains and losses associated with available-for-sale ("AFS") debt securities to be recognized in OCI contributes to an accounting mismatch between foreign denominated insurance liabilities and foreign denominated AFS debt securities.

However, we believe that the recognition of foreign exchange gains and losses in income versus in OCI should be aligned with the nature of the underlying component of a debt instrument measured at FV-OCI, i.e.: the foreign exchange gains and losses on the amortized cost (which represents a monetary component of an asset) should be recorded in net income, whereas the foreign exchange gains and losses on the unrealized gain or loss (also commonly referred to as "mark-to market"), should be recognized in OCI consistently with the corresponding unrealized gain or loss amount (mark-to market) in the foreign currency.

## **7. Financial liabilities measured at fair value under the fair value option**

We agree with the proposed requirement to separately present in OCI the changes in fair value attributed to the instrument-specific credit risk for financial liabilities for which that entity has elected the fair value option. We agree with the Board's assessment that those liabilities are typically settled with the creditor and therefore changes in their fair value as a result of changes in the instrument-specific credit risk usually are not realized.

We are supportive of the early adoption of this proposed requirement. However, we recommend that the Board consider applying this requirement in a consistent manner to all liabilities at FV-NI.

## **8. Effective date**

We strongly support the view that for (re)insurers the new proposed guidance for financial instruments should be applicable concurrently with the new guidance for insurance contracts. Otherwise, it may put into question the usefulness of financial reporting for users in the period between the adoption of the financial instruments project and the insurance contracts project by impairing users' ability to effectively analyze performance of the reporting entity. In the situation where the effective dates are different, it is critical that a one-time re-alignment be provided in order to recognize and measure financial instruments in accordance with or in the context of the guidance for insurance contracts.

Nevertheless, the changes to the classification and measurement model, as proposed, would be substantial and would require enhancements to policies, procedures, and systems, as well as significant detailed research regarding various features embedded in financial instruments and how they would be assessed under the SPPI Test. In order to implement the requirements, we believe the effective date should be no sooner than three years from the release of the final guidance.

In addition, we believe that the new model should only be implemented concurrently with a complete guidance on financial instruments, and at least with a finalized guidance on credit impairments.

Thank you for the opportunity to present our views. We hope you find our comments informative and useful. If you have any questions regarding the content of this letter, please do not hesitate to contact me.

Yours sincerely,



Martin Mueller  
Chief Accounting Officer  
Swiss Re Ltd