Michael Monahan
Senior Director, Accounting Policy

May 15, 2013

Ms. Leslie Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2013-220: Proposed Accounting Standards Update, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

Dear Ms. Seidman:

The American Council of Life Insurers ("ACLI")[1] appreciates the opportunity to comment on the "*Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities –* Exposure Draft" ("ED").

GENERAL COMMENTS

We support the Board's objective to provide more decision useful information about an entity's involvement in financial instruments, while reducing complexity in accounting for those financial instruments. However, we do not believe the ED meets this objective for insurance entities and would actually result in providing less decision useful information and increasing complexity if the guidance is adopted as proposed. The prominence of the cash flow characteristics assessment in the proposed guidance will result in many instruments being measured at fair value with changes in fair value being recorded in net income ("FV-NI") despite many of these instruments being held within a business model to hold these assets for purposes other than trading or selling within the near term. As a result, the volatility from the increased use of FV-NI instruments under the proposed guidance will not be indicative of an insurance entity's performance and would provide misleading information to users related to the performance of an entity.

[1] The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with more than 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American Families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. Learn more at www.acli.com.

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We recommend the Board remove the cash flow characteristics assessment and revise certain aspects of the business model assessment for financial assets to better achieve the objectives identified by the Board. In lieu of the proposed cash flow characteristics assessment, we believe the Board could retain the existing bifurcation requirements for embedded derivatives if the Board believes such features should be recognized at FV-NI. However, we do not believe bifurcation or a cash flow characteristics assessment is necessary to achieve the objective of providing more decision useful information when determining the appropriate classification and measurement model. We believe an entity's business model is the appropriate basis for determining classification and measurement for financial assets while permitting certain exceptions to better align measurement mismatches with related liabilities. We believe that a classification and measurement model that is more focused on an entity's business model for managing a particular asset will provide more decision useful information, especially for an insurance entity, and would avoid unnecessary volatility from assets classified at FV-NI that may result from a model that places equal or more reliance on assessing the cash flow characteristics of an individual instrument.

If the proposed cash flow characteristics assessment is not removed, we believe there could be adverse market consequences to those instruments that may not meet the proposed SPPI test due to the increased volatility they may cause in financial statements. While we have highlighted this concern related to structured securities as well as equity instruments, there are likely other types of investments that may not meet the SPPI test that have yet to be identified or further evaluated in which the proposed guidance may have an impact on the marketability or desirability of those investments. We urge the Board to consider our alternatives described herein in order to meet the proposal's objectives.

We describe our recommendations in further detail below.

CASH FLOW CHARACTERISTICS ASSESSMENT

We believe the proposed cash flow characteristics assessment would increase the complexity of performing an instrument-level evaluation when compared to the embedded derivative bifurcation guidance that currently exists. We recommend replacing the cash flow characteristics assessment with the existing bifurcation guidance for embedded derivatives or remove the cash flow characteristics test entirely. This proposed modification would effectively maintain existing guidance that has been tested over several years and is well understood.

As detailed in our response to the questions in the appendix, we believe the proposed cash flow characteristics assessment to determine if an instrument's cash flows represent solely payments of principal and interest ("SPPI test") could result in minor features not meeting the SPPI test and, therefore, the instrument would be classified at FV-NI. While we can appreciate that such an outcome (FV-NI) for minor features may not have been the Board's intent with the proposed criteria, we believe the proposed SPPI test introduces unnecessary complexity and would need significant modifications and additional application guidance to fully address instances where these minor features may result in FV-NI classification. We believe that such modifications to the SPPI test are not practical and would be perceived as more complex to preparers when compared to the existing embedded derivative bifurcation requirements.

Additionally, we are concerned that the punitive nature of classifying an entire financial asset at FV-NI would increase the risk of potential restatement that could arise if a minor feature is identified subsequent to the release of financial statements that would result in an instrument or group of instruments not meeting the proposed SPPI test. While a similar risk exists today under the bifurcation requirements, the bifurcation of an embedded derivative from these types of minor features likely would not impact the financial statements as significantly, compared to the change in value of the entire instrument. Accordingly, the proposed guidance would require a significant amount of costs to preparers in order to build the necessary controls and processes to evaluate their financial assets at a detailed enough level to be able to conclude whether or not the instrument meets the cash flow characteristics assessment. While modifications could be made to the proposed guidance, we believe that it is not practical for the Board to include very detailed or specific guidance that contemplates all of the various features that may exist in a variety of instruments today or anticipate features that may exist in future instruments. As a result, we would not recommend the Board simply attempt to modify the proposed criteria to alleviate the concerns expressed herein but, rather, recommend removing the proposed SPPI test.

As we stated in our unsolicited comment letter in November 2012, we continue to oppose the application guidance in the proposed guidance related to structured securities. The requirement to assess whether there is disproportionate credit risk associated with the instrument would effectively result in most structured securities being classified at FV-NI when there are various levels of subordination in the beneficial interests. While subordination in beneficial interests does create disproportionate credit risk, this type of disproportionate credit risk exists for corporate bonds where senior notes or subordinated notes could be issued by an entity but would not impact how these instruments would be classified under the proposed guidance. The resulting classification of FV-NI for beneficial interests would not provide decision useful information to investors when these instruments are not held for trading purposes.

In addition, the proposed guidance for beneficial interests requires a look-through evaluation of the underlying collateral that is not practical or feasible to perform. We recommend beneficial interests be evaluated similar to any other financial asset for determining the appropriate classification and measurement, which as noted above should primarily be based on the business model assessment. See our response to the questions in the Appendix for more details related to the concerns we continue to express about structured securities.

If the Board decides to keep the proposed cash flow characteristics assessment, which we oppose, we recommend that the Board perform extensive field testing of the proposed guidance to better understand the required cost and time commitment involved in performing the analysis necessary for the cash flow characteristics assessment as well as ensuring that the Board is fully aware of instruments that would fail the cash flow characteristics assessment (and be classified as FV-NI).

BUSINESS MODEL ASSESSMENT

Along with the proposed changes to the cash flow characteristics assessment, we believe the business model assessment would be more easily performed and provide more decision useful information for users of the financial statements of insurance entities if the default category for financial assets was fair value with changes in fair value recognized in other comprehensive income (FV-OCI) for assets that are not held for trading purposes. As a result of this change and the change described above, we would expect both debt and equity instruments that are not held for trading will be recorded at FV-OCI. Along with making FV-OCI the default category, the Board could permit entities to use AC if certain conditions were met. Those conditions could be applied to debt instruments that meet the proposed AC business model (with revisions as described below). These proposed changes would simplify the proposed guidance and would provide more decision useful information. We would also retain the proposed guidance to allow FV-OCI assets to elect FV-NI.

To ensure the business model assessment results in more decision useful information compared to the proposed guidance, we recommend the Board modify the application guidance related to the amortized cost (AC) business model to be less restrictive to avoid unnecessarily reducing an entity’s ability to utilize this category. As currently written, the restrictive nature for when sales can occur under the AC business model will make it difficult for an entity to reach a determination that certain sales activity will not occur in the future. While we recognize the ED does not contain any explicit tainting provisions with respect to sales of assets that are classified at amortized cost, we remain concerned that the application of the business model could develop in such a way that could limit the use of this category. Our concern relates to changes in circumstances that may not have been anticipated by management that could lead to sales of assets classified at amortized cost, where this hindsight could be used to question management's initial judgment with respect to meeting the amortized cost business model. We recommend adding explicit guidance that would avoid this type of hindsight application.

FV-OCI OPTION TO BETTER ALIGN MEASUREMENT MISMATCHES

If the Board does not agree with our proposed changes above to have FV-OCI be the default measurement category for financial assets, we believe the Board should include a FV-OCI option when measuring assets at FV-OCI to reduce or mitigate an accounting mismatch regardless of the cash flow characteristics or business model. For example, there are certain instances where assets supporting insurance contract liabilities may be measured at AC or FV-NI where FV-OCI would provide an asset measurement more consistent with the related liabilities. We believe such a FV-OCI option would effectively be limited to assets backing liabilities in the scope of the Insurance Contracts standard and where changes in the discount rate are recorded in OCI. This FV-OCI option would better align the measurement of assets and liabilities for insurance contracts and may provide more relevant and useful information to financial statement users.

EFFECTIVE DATE & TRANSITION

As the Financial Instrument project's Impairment proposal is directly related to the Classification and Measurement proposal, we recommend that the effective dates coincide. Additionally, given the interaction of the Financial Instrument projects (Classification and Measurement as well as Impairment) and the Insurance Contracts project, we recommend the Board align the effective date of the Financial Instruments projects with the effective date of the Insurance Contracts project. In the event that alignment of the effective dates with the Insurance Contracts project is not possible, the Board should consider permitting an insurance entity to defer the adoption of the proposed guidance until the effective date of any changes to the Insurance Contracts guidance. We do, however, acknowledge and support the tentative decision of the Board with respect to the Insurance Contracts project that provides a reporting entity the option to adopt certain aspects of Classification and Measurement retrospectively in conjunction with the retrospective adoption of the proposed Insurance Contracts standard.

The following Appendix provides answers to the specific ED questions in light of our expressed views. Additionally, we have attached our unsolicited comment letter that was submitted in November 2012 related to our concerns regarding structured securities.

Sincerely,

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Michael Monahan
Senior Director, Accounting Policy

cc: Shahid Shah, Practice Fellow
Nga Zimmerman

APPENDIX
QUESTIONS FOR RESPONDENTS

Scope

Questions for All Respondents

Question 1: Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments should be included or excluded from the guidance in this proposed Update and why?

ACLI agrees with the scope of the proposed update. However, there are certain liabilities issued by insurers that may default to being in scope of the proposed amendments because they do not meet the scope definition of the Insurance Contracts project. As a result, the proposed scope is difficult to fully evaluate given the interrelated nature of the two projects. We recommend the Board continue to consider these interrelationships prior to finalizing both projects and recommend alignment of the effective dates for these projects, as discussed in further detail within our response to Question 32.

Question 2: Do you agree with the industry-specific specialized guidance scope exceptions in paragraph 825-10-15-9? If not, why? What would you propose instead?

ACLI agrees with the retention of the industry-specific specialized guidance but is concerned that the scope exceptions for Investment Companies may result in certain instances where the assets or liabilities of the Investment Company may be in-scope of the proposed guidance because the scope exception only references debt and equity securities in subtopic 946-320. We recommend the Board consider the other assets and liabilities that are typically included in Investment Companies to ensure this scope exception is sufficient and will retain existing guidance for these entities.

In addition to retaining the industry-specific specialized guidance, we urge the Board to consider providing new specialized industry-specific guidance for insurers to allow for better alignment in the measurement of financial assets and financial liabilities that are associated with insurance contracts. We believe the Board should include a FV-OCI option when measuring financial assets or liabilities at FV-OCI which would reduce or mitigate an accounting mismatch regardless of the cash flow characteristics or business model. For example, there are certain instances where assets supporting insurance contract liabilities may be measured at AC or FV-NI where FV-OCI would provide an asset measurement more consistent with the related liabilities. For example, insurers may have certain financial assets that would be measured at AC but may have certain liabilities where the changes in discount rate are recorded in OCI. By having a FV-OCI option, an insurer would be able to measure the financial assets at FV-OCI to reduce the accounting mismatch in OCI due to the measurement differences. Similarly, certain liabilities issued by insurers may be considered financial liabilities and would be measured at AC under the proposed guidance while the related assets may be recognized at FV-OCI under the proposed guidance. In this case, an insurer would be able to elect FV-OCI for measurement of the financial liability to reduce the accounting mismatch from the measurement differences.

We believe such a FV-OCI option would effectively be limited to assets backing liabilities in the scope of the Insurance Contracts standard and where changes in the discount rate are recorded in OCI. This FV-OCI option would better align the measurement of assets and liabilities for insurance contracts and provide more relevant and useful information to financial statement users.

Recognition

Questions for All Respondents

Question 4: Do the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment? If not, why? What would you propose instead?

The proposed contractual cash flow characteristics assessment is unnecessarily complex and could result in many instruments that would be measured in their entirety at FV-NI despite an entity's business model to hold these assets. We are supportive of bifurcation of embedded derivatives in US GAAP as it is well tested and well understood in its current form and would eliminate these concerns. While we believe bifurcation of embedded derivatives is not a necessary component of the classification and measurement model for financial assets and would support simply classifying and measuring financial assets based on an entity's underlying business model, we recognize there would likely be a desire to perform some assessment on the individual instrument prior to assessing an entity's business model. Accordingly, we recommend the existing bifurcation requirements as opposed to the proposed cash flow characteristics assessment.

However, should the Board adopt the SPPI test, we believe it should be modified to provide that the contractual cash flows do not have to be solely payments of principal and interest; rather, substantially payments of principal and interest.

We are concerned that application of the SPPI test could result in insignificant or unlikely-to-occur contractual features determining the classification and measurement. We believe that many financial instruments may have contingent contractual cash flows that are, in general, fees that may be not related to credit and are unsure if this is an unintended consequence of the contractual cash flows characteristics assessment. For example, commercial mortgage loans and private placement debt securities have many fees contractually written into the documents and while some may be related to credit there are some that may not be credit-related such as a fee for minor noncredit-related amendments to documents. Typically, these types of noncredit cash flows are not meant to be a material part of the financial instrument's return. Additionally, within many asset-backed securities, there may be fees in the underlying collateral that may be passed on through the trust's cash flows. One example may be the annual fees or any late fees charged to the credit card borrower in a secured credit card transaction. It may be impracticable to assess all these features.

Illustrative Example G: Perpetual Instruments discusses that fact that if there is a possibility that the security may defer interest and not accrue additional interest on that deferred interest, it would fail the SPPI test. Outside of perpetual instruments, we believe that the majority of beneficial instruments that are tranched based on subordination have this type of deferral feature. There is a possibility to create a deferral of interest rather than create a technical default and those cash flows are diverted to the highest tranche either temporarily or permanently. Currently, if this occurs, debt securities are impaired for these shortfalls of interest. Theoretically, the likelihood of these deferrals would already be included in the credit loss allowance that may be created by the proposed Financial Instrument Expected Credit Loss model. Therefore, we do not believe a deferral feature should be a consideration when determining the classification and measurement of an instrument.

Additionally, a call option on a debt instrument, which if fair valued on its own would comprise a relatively small portion of the overall fair value of the instrument, may inappropriately result in disqualifying the entire financial instrument from being considered <u>solely</u> payments of principal and interest even though the instrument cash flows are <u>substantially</u> payments of principal and interest. A significant amount of private (and some public) debt securities and commercial mortgage loans, but typically not residential loans, have call prices above par value of the financial instrument. It is not clear to us as to whether or not these prepayment fees as a fixed price above par or as a calculated make-whole fee would be *considered SPPI. Make-whole fees, in general, represent future interest payments not received due to the prepayment of the security or loan and are compensation to the lenders for reinvesting at typically a lower rate subsequent to the prepayment.*

Consequently, the impact to net income, driven typically from interest and general credit spread changes rather than these types of features, would not be proportionate to the significance of the feature in determining classification and measurement and there is no consideration of the likelihood of certain possible features even occurring. Therefore, if the Board does not decide to remove the SPPI test as we have recommended, then we recommend that the Board modify the SPPI test from "solely" payments of principal and interest to "substantially" payments of principal and interest allowing insignificant and unlikely features to not drive the classification and measurement. Such a modification would simplify the application of the model and would also reduce our concern that less than significant contractual features would render an entire financial instrument as FV-NI.

While companies generally have sufficient knowledge about the typical features producing cash flows of the securities and loans they acquire or originate to properly assess current embedded derivative guidance, they may not have the appropriate level of knowledge of the insignificant features that may generate additional cash flows especially when certain of those cash flows may have a remote possibility of occurring. When originating financial instruments, companies may be able to more easily assess these characteristics as these features are in their approved contracts. However, when acquiring financial assets such as debt securities, this assessment must be done on an individual instrument basis. It is required on all existing holdings and then must be done prior to the purchase of new acquisitions to properly classify financial instruments at the acquisition date. Some companies have securities analysts in-house that may be able to assist in this analysis, while others rely on investment managers and may not be able to perform this additional analysis. Operationally, the effort and additional cost needed to build processes and procedures to determine, categorize and assess contractual cash flow characteristics will be immense and the audit process will become much more complex, but will still not result in providing more decision useful information from applying the SPPI test.

Therefore, from both an operational and theoretical standpoint, we believe that the SPPI test for assessing contractual cash flows is inoperable.

Question 5: The proposed amendments define *principal* as the amount transferred by the holder at initial recognition. Should the definition of *principal* be expanded to include repayment of the principal amount at maturity or other settlement? If so, what instruments would fail (or pass) the contractual cash flow characteristics criterion as a result of this change?

The proposed definition of principal appears to cause certain instruments that are purchased at a significant premium or discount to the instrument's par value to fail the SPPI test when the instrument can be called or prepaid (even when the instrument would not meet the double-double test for embedded derivatives today). While we believe expanding the definition to include repayment of the principal amount at call date or maturity would help alleviate some of these concerns, we would still be concerned with the application of the cash flow characteristics assessment in the proposed guidance. We do not agree that the ability for the issuer to call a financial instrument that is at a more than insignificant discount, for example, should be considered as part of the SPPI test. See our response to Question 4 for our recommendation with respect to the proposed guidance to better achieve the stated objective of the proposal.

Question 6: Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?

While the proposed amendments contain detailed application guidance, we recommend that the Board perform extensive field testing of the proposed guidance to better understand the required time commitment involved in performing the analysis necessary for the cash flow characteristics assessment as well as ensuring that the Board is fully aware of instruments that would fail the cash flow characteristics assessment (and be classified as FV-NI). We believe there may be a significant amount of financial instruments that fail the SPPI test due to insignificant features existing in many financial instruments. See our response to Question 4 for our recommendation with respect to the proposed guidance to better achieve the stated objective of the proposal.

Question 7: Should a financial asset with a contractual term that modifies the economic relationship (see paragraphs 825-10-55-17 through 55-20) between principal and interest be considered to contain cash flows that are solely payments of principal and interest? Should this be the case if, and only if, the contractual cash flows could or could not be more than insignificantly different from the benchmark cash flows as discussed in paragraph 825-10-55-19? If not, why? What would you propose instead?

While we believe a financial asset with a contractual term that modifies the economic relationship should be considered to meet the SPPI test, we believe that a more effective and less complex way to evaluate these unique contractual terms is through retaining the bifurcation of embedded derivatives guidance that exists today and is well understood. While the bifurcation guidance that exists today can be viewed as complex, the proposed guidance for evaluating modified economic relationships is equally (if not more) complex (e.g., involving the use of a benchmark instrument, etc.) and does not achieve the stated objective of reducing complexity compared to existing guidance. Therefore, there is no added benefit that would outweigh the cost of implementation and on-going efforts to apply the proposed guidance. For example, we believe many entities would need to perform extremely detailed evaluations of thousands of securities to appropriately understand all of the contractual provisions to adequately assess whether the instruments meet the SPPI test. We believe these added costs for preparers in both time, resources, and additional processes do not provide any additional benefit to users of the financial statements. As noted on our response to Question 4, we recommend the Board replace the proposed cash flow characteristics assessment with the existing bifurcation requirement for embedded derivatives, with any resulting host contract being evaluated under the proposed business model assessment.

Question 8: Do the proposed amendments contain sufficient application guidance in paragraphs 825-10-55-17 through 55-20 on assessing a modified economic relationship? If not, why?

As stated in our response to Question 4, the cash flow characteristics assessment is overly complex and should be removed from the proposed guidance. The inclusion of the additional guidance on modified economic relationships demonstrates the complexity that is involved in the evaluation of the cash flow characteristics test. We recommend retaining bifurcation of embedded derivatives for assets in place of the cash flow characteristics assessment in the proposal.

Question 9: For beneficial interests in securitized financial assets, the proposed amendments would require an entity to look through to the underlying pool of instruments in determining whether the tranche contains payments of solely principal and interest. Do you agree with this look-through approach? If not, why? What would you propose instead?

We do not agree with the look-through approach for beneficial interests. As noted in Question 4 above, we recommend the Board retain bifurcation and eliminate the cash flow characteristics assessment from the proposed guidance. By retaining bifurcation, any embedded derivatives would be bifurcated prior to assessing the business model to determine the appropriate classification and measurement category of the host instrument.

If the proposed cash flow characteristics assessment is retained, we recommend beneficial interests be evaluated based on the contractual features of the individual instrument, rather than performing the look-through assessment described in the proposal. When evaluating the individual instrument, investors can typically assess embedded derivatives contained within the securitized assets. The proposed look-through approach to beneficial interests is overly burdensome and effectively requires detailed evaluation of the terms of the underlying pool of instruments as well to determine if the proposed criteria are met to be classified in a category other than FV-NI. Typically, the level of detailed information necessary to evaluate the underlying pool in a detailed manner is not readily available. Similar to the reasons noted above with respect to our concerns related to the cash flow characteristics test, we do not believe such an assessment should result in an instrument being classified at FV-NI. The proposed guidance for beneficial interests will result in many, if not most, beneficial interests being recorded at FV-NI (i.e., most subordinated tranches as well as insignificant features and the potential to defer interest affecting the SPPI test) and such would not provide decision useful information to financial statement users when an entity's business model is not to engage in actively trading/selling these assets. Below outlines some of our additional concerns with the application guidance for beneficial interests.

<u>Specific Concerns With Application Guidance For Beneficial Interests</u>
The requirement in the proposed guidance (825-10-55-26(c)) to consider "all circumstances" when considering the disproportionate credit risk criteria could effectively result in all tranches other than the most senior tranche being classified as FV-NI, which we do not believe is appropriate. As noted in the ACLI's comment letter on this matter submitted in November 2012, we are concerned this proposed guidance would have a significant impact on insurers and the marketability of these types of investments.

Classification at FV-NI for beneficial interests simply due to subordination that is created by tranching is not consistent with the treatment of other debt instruments issued by corporations where debt can be issued out of an entity and could effectively be subordinate to borrowings of the same entity as well as other entities in the same corporate structure. For example, assume a corporate structure has a holding company and an operating subsidiary that both have senior unsecured notes outstanding and assume the operating company debt has priority over the holding company debt as a result of the corporate structure. Assuming the unsecured notes issued by both entities are 'plain vanilla' debt instruments that would meet the SPPI test, the holders of these unsecured notes could classify these instruments at amortized cost ("AC") or FV-OCI, despite the fact that the unsecured note at the holding company is structurally subordinate to the unsecured note issued by the operating company. While beneficial interests are generally backed by an underlying pool of assets (as opposed to a business), the subordination through tranching of cash flows is akin to structural subordination within a corporate structure. Similar to corporate securities where subordination is not a relevant attribute in the SPPI test, subordination through tranching of structured securities should not impact the classification and measurement of a financial asset and should not be a relevant attribute in the SPPI test. Should the Board decide to retain the criterion to evaluate credit risk of the tranche versus credit risk of the underlying collateral pool, we recommend the evaluation not require "all circumstances" to be evaluated in determining if the SPPI test is met.

We note that the Board recently considered a similar issue of subordination through tranching of securities in 2010 when evaluating new guidance that was issued for embedded credit derivatives where the increased credit risk through subordination would not be considered an embedded derivative. However, under the proposed guidance, the Board seems to reverse that decision without sufficient justification as to what has changed since the adoption of the embedded credit derivative guidance that would indicate the existing accounting guidance should be amended or replaced.

In addition to the inconsistent treatment between beneficial interests and corporate instruments noted in the previous paragraph, the application guidance for beneficial interests appears to emphasize credit risk *as the main reason for having assets with higher disproportionate risk failing the SPPI test. As stated in the attached letter to the FASB regarding structured securities, we believe credit risk should not be a relevant attribute when determining the appropriate classification and measurement category, rather credit risk should only be considered as a part of the impairment model for financial assets.*

Even though we are still in the early stages of our evaluation of the SPPI test as it applies to financial instruments held by many of our members, we are recognizing other concerns with features that may be common in collateralized vehicles that may cause these instruments to fail the SPPI test and be recorded at FV-NI. For example, certain collateralized vehicles permit the investment manager to actively manage the underlying assets and/or reinvest proceeds to acquire new investments. As a result of the application guidance for beneficial interests, we believe the ability to enter into a transaction that could possibly fail the SPPI test would result in all of the tranches issued by the vehicle being recorded at FV-NI resulting in additional volatility in net income despite the resulting cash flows being predominantly (if not entirely) payments of principal and interest. We do not agree that ability should necessitate FV-NI classification and recommend that the guidance be modified as previously suggested to allow the ability to bifurcate the embedded derivative from the host contract, if a feature becomes present due to the potential active management, and to record only the embedded derivative portion of the change in fair value in the income statement.

We also have concerns with determining what instruments should be considered beneficial interests subject to this detailed application guidance when certain instruments use trusts and other similar mechanisms to facilitate the issuance of bonds in the marketplace. For example, trusts may be used for the issuances of special revenue bonds from municipalities where the bonds are supported by a stream of cash flows (for example, tolls from a local highway), but may not incorporate subordination through tranching of the cash flows. It is unclear whether the bonds issued would be considered a 'beneficial interest' subject to the application guidance and whether the cash flows would be considered to meet the SPPI test because the revenue bonds do not contain an underlying instrument that would meet the SPPI test. Other examples include bonds issued from a trust that is funded with the lease payments from a commercial building where it is unclear how the lease payments would be assessed under the SPPI test.

Question 10: Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?

No. We do not believe the proposed amendments appropriately convey the principle associated with the business model assessment in all cases. We believe the restrictions that result from application of the SPPI test will in some cases cause financial instruments to be classified and measured at FV-NI in cases where such classification and measurement is inconsistent with the business model of life insurance companies. This is further exacerbated by the fact that FV-NI is the "default" measurement category under the proposed model. We support an approach that would specifically define the criteria for classifying and measuring financial assets at AC or FV-NI and would utilize FV-OCI as the "default" category. We believe that financial instruments when not held for trading purposes should be recognized at AC (when AC is met and the entity does not elect FV-OCI instead) or FV-OCI based on the underlying business model of holding to collect cash flows or both holding to collect cash flows and selling the financial assets. This approach would consider both the reporting entity's strategy for the financial assets as well as its business model.

Alternatively, we believe the Board should include a FV-OCI option when measuring assets at FV-OCI would reduce or mitigate an accounting mismatch regardless of the cash flow characteristics or business model. For example, there are certain instances where assets supporting insurance contract liabilities may be measured at AC or FV-NI where FV-OCI would provide an asset measurement more consistent with the related liabilities, which may be re-measured with changes in discount rate being reflected in OCI. We believe such a FV-OCI option for financial assets would effectively be limited to assets backing *liabilities in the scope of the Insurance Contracts standard and where changes in the discount rate are recorded in OCI. This FV-OCI option would better align the measurement of assets and liabilities for insurance contracts and provide more relevant and useful information to financial statement users.*

Question 11: Do the proposed amendments provide sufficient application guidance and illustrations on how to distinguish among the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the proposed guidance provided to describe those business models? If not, why?

We are concerned with the application guidance associated with the business model to classify an asset at AC. The proposed application guidance appears to be very restrictive and could result in many portfolios of assets not meeting the AC business model when AC would be more consistent with how an entity manages those assets. We recommend using similar application guidance for the AC business model that was used in the most recently proposed amendments to IFRS 9 where sales that were frequent but insignificant – as well as significant but infrequent – could still be consistent with the AC business model. Additionally, we believe the application guidance could be simplified if FV-OCI was the default category. This would allow an entity to classify a financial asset at FV-OCI as long as that asset was not managed in a portfolio that was classified at AC or FV-NI (based on the proposed application guidance). By changing the default category to FV-OCI, the proposed classification and measurement model would still achieve the objective of reducing complexity from today's model and maintaining the decision useful information in today's model that results in non-trading assets being recorded and measured at something other than FV-NI.

Question 12: Should the classification and measurement model for financial instruments contain an explicit tainting notion or should it rely on the principle and exercise of professional judgment? Why?

We believe the classification and measurement model for financial instruments should rely on the principle and exercise of professional judgment. While we recognize the ED does not contain any explicit tainting provisions with respect to sales of assets that are classified at amortized cost, we remain concerned that the application of the business model could develop in such a way that could limit the use of this category. Our concern relates to changes in circumstances that may not have been anticipated by management that could lead to sales of assets classified at AC, where this hindsight could be used to question management's initial judgment with respect to meeting the AC business model. We recommend adding explicit guidance that would avoid this type of hindsight application.

Question 13: The proposed amendments would require loan commitments, a revolving line of credit, or a commercial letter of credit (the potential creditor) to be measured on the basis of the likelihood of exercise of the commitment and the classification of the underlying loan that would be made upon exercise of the commitment. Do you agree with the proposed classification of loan commitments? If not, why? What would you propose instead?

While we have loan commitments that may be impacted by the proposed amendments, we do not have concerns with the approach that would classify loan commitments consistent with the loan that would be issued. However, our concerns about the cash flow characteristics test as discussed in Question 4 are equally applicable to commitments for loans that would not meet the SPPI test.

Initial Measurement

Questions for All Respondents

Question 14: Do you agree with the initial measurement principles for financial instruments? If not, why?

ACLI agrees with the initial measurement principles for an asset classified at amortized cost or FV-OCI based upon the transaction price and does not object to the initial measurement principles of fair value for asset classified at FV-NI.

Subsequent Measurement

Questions for All Respondents
Question 16: Should financial liabilities subsequently be measured at amortized cost, unless certain exceptions are met? If not, why?

ACLI agrees with the subsequent measurement criteria for financial liabilities. However, as noted in response to Question 2, there are certain instances where amortized cost measurement may not be appropriate and such circumstances are not currently addressed within the exceptions in the ED. As noted in our response to Question 2, there are certain liabilities issued by insurers where measurement at AC may not provide decision useful information where assets are measured at FV-OCI. Accordingly, we recommend a FV-OCI option for the measurement of the liability when such an election would reduce an accounting mismatch.

See our response to Question 17 below describing situations where nonrecourse liabilities may not meet the requirements to be measured similar to the related assets and result in an accounting mismatch under the proposed guidance for the nonrecourse liability and related assets.

Question 17: The proposed amendments would require a nonrecourse financial liability that is settled with only the cash flows from the related financial assets (see paragraph 825-10-35-11) to be measured on the same basis as those assets. Do you agree with the proposed amendments? If not, why? What would you propose instead?

For certain consolidated variable interest entities or other securitization entities, we have concerns that the proposed guidance does not provide sufficient flexibility to ensure that the assets and related liabilities will be measured in a way that provides the most decision useful information to investors.

In certain circumstances, nonrecourse financial liabilities may be backed by financial assets and non-financial assets (real estate owned as a result of foreclosure). Based on the proposed guidance in 825-10-35-11 that does not permit the nonrecourse financial liability to be measured on the same basis as assets when both financial and non-financial assets are used to settle the liability, we believe the proposed guidance would result in the nonrecourse liability being measured at amortized cost. As a result, there may be a measurement mismatch that would exist between certain liabilities and their related assets. In order to achieve the appropriate matching between nonfinancial assets/financial assets and related financial liabilities, companies currently elect the fair value option under ASU 825. The matching of accounting results provides decision useful information to users of their financial statements. We recommend the Board consider changes to the proposed guidance that would enable entities to better align the measurement of assets and liabilities in these situations to enable entities to continue to utilize the fair value option.

Question 18: The proposed amendments would require financial assets measured at amortized cost that are subsequently identified for sale to continue to be classified and measured at amortized cost less impairment and would prohibit recognition of the gain, until the sale is complete. Do you agree with the proposed classification and measurement requirements? If not, why?

ACLI agrees with the proposed requirements to measure amortized cost assets as amortized cost less impairment when those assets are subsequently identified for sale. While we agree with this requirement, the proposed guidance does not indicate whether the impairment should be based upon *the evaluation of the individual asset or group of assets that will be sold in order to determine the amount of impairment recognized for these assets. Additionally, we believe the Board should clarify the proposed guidance for determining impairment of FV-OCI assets when an entity has made a decision to sell certain assets. It is unclear under the proposed guidance for classification and measurement as well as the proposed guidance for impairment whether an entity would be required to recognize an impairment or loss for FV-OCI assets where a decision to sell has been made.*

Question 19: The proposed amendments would provide a practicability exception for measuring equity investments without readily determinable fair values that do not qualify for the practical expedient in paragraph 820-10-35-59 (that is, the net asset value per share expedient) and a one-step impairment model for all equity investments subject to the practicability exception. Do you agree with the proposed amendments? If not, why?

Current accounting guidance (944-325-30-1) requires insurers to report all equity securities at fair value regardless of whether fair value is readily determinable (that is marketable or nonmarketable equity securities). We believe current GAAP for insurers should be retained whereby these instruments would be measured at FV-OCI if they were not held for trading purposes. As a result, we do not believe there is a need for the practical expedient. To the extent current GAAP for insurers is retained, we do not believe the proposed one-step impairment model should be utilized to determine impairment. We believe existing impairment guidance for equity securities could be retained, as this guidance has been applied over several years where entities have established appropriate processes and procedures for identification of equities that are other-than-temporarily impaired.

Question 20: Should an entity evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value with qualifying changes in fair value recognized in other comprehensive income separately from the other deferred tax assets of the entity (rather than combined and analyzed together)? If not, why?

We agree that an entity should have the ability to separately assess and separately apply tax planning strategies (i.e., hold to maturity/recovery) when considering the need for a valuation allowance on its deferred tax assets arising from unrealized losses on debt instruments. Recognizing and addressing the uniqueness resulting from the interaction of accounting requirements of ASC 740 and ASC 320 is very helpful and will further support accuracy and consistency within the financial statements.

However, specific clarification may be warranted to avoid unintended consequences and possible inconsistencies among entities in the future. For example, clarification could assure that 1) one can continue to support unrealized losses in other comprehensive income ("OCI") where a company has carryback potential, the ability to generate future taxable income (whether ordinary or capital), and/or other deferred tax liabilities that can be used to support the unrealized loss; 2) unrealized gains in OCI can be used to realize other deferred tax assets regardless of whether or not the deferred tax asset originated in OCI; and 3) a deferred tax asset pertaining to the fair value of OCI debt instruments that would simply reverse over time as the unrealized losses reverse would not require future taxable income to support the realization of the deferred tax asset. We suggest including clarifying language in the guidance or within the basis for conclusions to illustrate the intent of separate evaluation and the use of tax planning strategies consistent with current practices. Additionally, we encourage the Board to replace "shall" with "can" to allow companies flexibility in applying tax planning strategies in the future.

Furthermore, we believe that the definition should be broadened to encompass deferred tax assets on unrealized losses from all debt instruments for which similar tax planning strategies are prudent and feasible. As a result of the proposed cash flow characteristics assessment, certain debt instruments that are not held for trading purposes will be classified at FV-NI with unrealized gains/losses recorded in net income, whereby an entity should be able to make a similar assertion of holding to recovery/maturity as *a tax planning strategy similar to a debt instrument classified at FV-OCI. Accordingly, the proposed changes for deferred tax assets on unrealized losses should be broadened to include unrealized losses on financial assets that are measured at fair value (either FV-OCI or FV-NI) as long as the asset is not held for trading purposes.*

We also have concerns about the impact on deferred tax assets from the proposed guidance on expected credit losses where deferred tax assets may be created as a result of the allowance for credit losses. We ask the Board consider the implications to the proposed deferred tax asset guidance from the proposed expected credit loss model when re-deliberating this issue. We will provide additional comments regarding our concerns with the related deferred tax assets in our comment letter on the proposed expected credit loss model that is due later this month.

Question 21: Under the amendments in this proposed Update, hybrid financial assets would not be required to be analyzed for bifurcation under Subtopic 815-15 and would be assessed in their entirety on the basis of the proposed classification requirements. In contrast, hybrid financial liabilities would be assessed for bifurcation and separate accounting under Subtopic 815-15, and the financial liability host contract would be subject to the proposed amendments. Do you agree with this proposal? If not, why? What would you propose instead?

As noted in our responses above, we recommend the Board retain bifurcation of embedded derivatives (including both financial assets and liabilities). We believe the proposed guidance to remove bifurcation for assets and retain bifurcation for liabilities creates additional complexity and results in less decision useful information to investors as a result of more instruments being reported in their entirety at FV-NI. Along with retaining bifurcation of embedded derivatives, we believe an entity should be able to elect FV-NI when an embedded derivative exists that would otherwise require bifurcation as certain companies may want the flexibility for administrative ease.

Question 22: The proposed amendments would require reclassification of financial assets when a change in business model occurs and prescribes how those changes should be subsequently accounted for. Do you agree with the proposed amendment on reclassifications? If not, why?

We do not have any concerns or comments on the reclassification guidance.

Presentation

Questions for Preparers and Auditors

Question 26: The proposed amendments 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 fair value through other comprehensive income (see paragraphs 825-10-45-14 through 45-15). Is the proposed fair-value-based method provided for computing the foreign currency gain or loss component operable? If not, why? What would you propose instead?

We generally support the proposed changes to record the foreign currency gain or loss for FV-OCI assets in net income, which will result in greater consistency in the treatment of foreign currency denominated monetary assets. However, we would be more supportive of the proposed guidance if the determination of the foreign currency gain/loss was based on the amortized cost of the asset, as opposed to fair value under the proposed guidance. We believe amortized cost would be the more appropriate measure compared to fair value as this would be more consistent with how similar assets recorded at amortized cost would record foreign currency gains/losses. Using amortized cost for the measurement will capture the appropriate foreign currency gain or loss that will ultimately be realized at maturity. Using fair value for the measurement would transfer the unrealized foreign currency gain or loss attributable to temporary market value fluctuations into the income statement only to be reversed upon maturity.

Additionally, if an entity enters into derivatives to effectively hedge the foreign currency risk, these derivatives may better align with foreign currency gains/losses being based upon the amortized cost of the instrument and, therefore, an entity would not need to apply hedge accounting in order to get an effective offset to the foreign currency volatility that would be recognized related to the asset. For existing cash flow hedges of foreign currency denominated debt instruments, we assume that upon implementation we would reclassify the foreign currency component of an effective cash flow hedge in a similar manner as the impact on the debt instrument upon adoption for foreign currency gain/losses.

Disclosures

Questions for All Respondents

Question 29: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement would you change and why?

We believe the proposed presentation requirements outlined in 825-10-45-12 through 45-18 will result in unnecessary information (interest income, expected credit losses, fx remeasurement, realized gains/losses) being presented by each separate measurement category (AC, FV-OCI and FV-NI) on the face of the income statement. While we believe this information may be useful to users, we believe this level of disaggregated presentation is unnecessary on the face of the income statement and would be more appropriately presented within footnote disclosures.

Transition and Open Effective Date Information

Questions for All Respondents

Question 30: Should an entity be permitted to early adopt only the proposed presentation requirements related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the fair value option under the proposed requirements? If not, why?

While we do not have any specific concerns with respect to the proposed presentation requirements related to changes in instrument-specific credit risk, we agree with the Board's observation that recognizing a gain due to a decrease in credit standing can be potentially misleading and inappropriate because an entity often lacks the ability to realize the gains. We support how the proposed guidance attempts to resolve this concern by reflecting the change in fair value resulting from a change in the company's own-credit risk separately in other comprehensive income for financial liabilities when the fair value option is elected but believe there are similar concerns on embedded derivative liabilities where similar guidance could be applied. We believe the Board should make this presentation requirement for instrument-specific credit risk consistent across all financial liabilities recorded at FV-NI, including embedded derivative liabilities, when a company does not expect to realize any temporary gains or losses.

Question 31: Should the effective date be the same for both public entities and nonpublic entities?

As a result of our recommendation in Question 32 related to the timing of the effective date, we believe there would be sufficient time for both public and nonpublic entities to implement any changes associated with classification and measurement during that time period. See our response to Question 32 below for additional information related to how much time would be necessary to implement the proposed guidance.

Questions for Preparers and Auditors

Question 32: How much time is needed to implement the proposed guidance?

As the Financial Instrument project's Impairment proposal is directly related to the Classification and Measurement proposal, we recommend that the effective dates coincide. Additionally, given the interaction of the Financial Instruments project (Classification and Measurement as well as Impairment) and the Insurance Contract project, we recommend the Board align the effective date of any changes from the Financial Instruments project with any changes that result from the Insurance Contracts project. While adopting two significant accounting standards at the same time may create an additional burden on preparers, the alignment of these dates will avoid confusion on the part of users given the two standards are so closely linked.

Regardless of whether the Board aligns the effective date with any changes in the Insurance Contracts or Impairment project, we recommend an effective date of no earlier than 24 to 36 months after the standard is issued. Depending on the final changes required under the Classification and Measurement proposal, companies may need to perform detailed, individual evaluation on thousands of investments to determine whether these instruments meet the cash flow characteristics assessment under the proposed guidance. As a result, companies would need an extended amount of time to adequately prepare processes and systems for these changes at the same time many changes may be occurring as a result of any new Impairment proposal that is issued. Given the proposals in both of the Financial Instruments EDs would impact many of the same resources, an effective date of 24 to 36 months after the standard is issued would be needed to ensure companies are prepared to implement the proposed guidance.

Question 33: Are the transition provisions in this proposed Update operable? If not, why?

We do not currently have specific concerns with respect to the transition provisions in the proposed guidance. However, we believe the Board should continue to evaluate the transition guidance for the ED as well as the interaction with the Insurance Contracts project to ensure that there is consistency between the two transition methods (as appropriate) in establishing the balances within OCI as well as the amount that will ultimately be reflected in P&L.

Equity Method Accounting

Questions for All Respondents

Question 34: The proposed amendments would require investments that qualify for the equity method of accounting in Subtopic 323-10, Investments—Equity Method and Joint Ventures—Overall, to be subsequently measured at fair value with changes in fair value recognized in net income if the investment is held for sale at initial recognition. Are the proposed indicators/conditions operable? If not, why? What would you propose instead?

We are concerned that the proposed guidance will result in many of our partnership investments meeting the criteria to be considered held for sale due to the limited purpose and time frame in which the partnerships are typically established. As a result, these investments may be required to be measured at FV-NI despite the business model objective to hold these assets for return of principal and for extended periods of time. Many of these investments are illiquid or cannot be reasonably expected to be sold prior to the dissolution of the partnership and would result in providing misleading information if the investment was recorded at FV-NI. We recommend the Board carefully consider changes to the proposed guidance to allow entities to continue to report these investments using the equity method of accounting.

If the Board determines that the equity method of accounting for these investments should not be retained, we would reiterate our recommendation to modify the proposed guidance to remove the cash flow characteristics test. The proposed guidance should be changed to allow entities to record financial assets consistent with their business model and retain bifurcation of embedded derivatives. Based on our recommendations, these partnership investments that are not held for trading purposes would be *classified as FV-OCI and would provide more decision useful information related to an entity's objective for holding these investments, as opposed to the proposal where these would be classified as FV-NI.*

Question 35: The proposed amendments would change the current two-step impairment model for equity method investments to a one-step impairment model for all equity investments. Do you agree with the proposed one-step equity impairment model? If not, why? What would you propose instead?

We believe the existing two-step impairment model for equity method investments should be retained. Otherwise, temporary declines in value would be reported as net income when they may never be realized. Our recommendations herein would result in more equity instruments being classified at FV-OCI and believe the existing impairment model for equity securities could be used as the basis for determining when an equity investment is impaired (including equity method investments).

Nonfinancial Hybrid Instruments

Questions for All Respondents

Question 37: The proposed amendments would eliminate the fair value option for hybrid nonfinancial instruments in current U.S. GAAP and would provide a new fair value option for hybrid nonfinancial liabilities. For a hybrid nonfinancial liability, an entity would apply the bifurcation and separate accounting requirements in Subtopic 815-15 and account for the embedded derivative in accordance with Topic 815. The financial liability host that results from separation of the nonfinancial embedded derivative would be subject to the proposed amendments. However, an entity would be permitted to initially and subsequently measure the entire hybrid nonfinancial liability at fair value (with changes in fair value recognized in net income) if after applying Subtopic 815-15 the entity determines that an embedded derivative that requires bifurcation and separate accounting exists. In contrast, for a hybrid nonfinancial asset the proposed amendments would require the hybrid contract to be measured at fair value (with changes in fair value recognized in net income) if the hybrid nonfinancial asset contains an embedded derivative that would have required bifurcation and separate accounting under Subtopic 815-15. Do you agree with the proposed amendments? If not, why? What would you propose instead?

While many of our member companies do not have hybrid nonfinancial assets or liabilities, we are concerned with the proposed guidance that would eliminate the bifurcation of embedded derivatives for assets. As noted in our responses above, we recommend the Board retain bifurcation of embedded derivatives (including both financial and non-financial assets and liabilities). We believe the proposed guidance to remove bifurcation for assets and retain bifurcation for liabilities creates additional complexity and results in less decision useful information to investors as a result of more instruments being reported in their entirety at FV-NI. Along with retaining bifurcation of embedded derivatives, we believe an entity should be able to elect FV-NI when an embedded derivative exists that would otherwise require bifurcation.

Michael Monahan
Senior Director, Accounting Policy

November 5, 2012

Ms. Leslie Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Tentative Financial Instruments Classification & Measurement Model

Dear Ms. Seidman,

The American Council of Life Insurers (ACLI)[1] has been closely following the FASB Board (Board) deliberations on Financial Instruments. In the October 17 Board meeting on Classification & Measurement (C&M), the FASB tentatively adopted application guidance similar to IFRS 9, *Financial Instruments*, to determine if contractually linked instruments (i.e., structured securities) meet the cash flow characteristics of solely principal and interest. If certain conditions are not met, structured securities would be required to be reported at fair value with periodic changes in fair value recognized in net income (FV-NI). We are concerned about the Board's tentative decision as we believe reporting investments in structured securities at FV-NI could result in significant earnings volatility for insurers that would be viewed negatively by investors. As large investors in structured securities[2], it could also reduce our desire to invest in the impacted securities.

The FASB's tentative model contains three conditions which, if present, result in the cash flow characteristics being considered solely principal and interest. Depending on the business model, a financial asset that meets the solely principal and interest conditions may be reported at either fair value with periodic changes in fair value reported in other comprehensive income (FV-OCI) or amortized cost (AC). If the financial asset does not meet

[1] The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. ACLI advocates in federal, state, and international forums. Its members represent more than 90 percent of the assets and premiums of the U.S. life insurance and annuity industry. In addition to life insurance, annuities and other workplace and individual retirement plans, ACLI members offer long-term care and disability income insurance, and reinsurance. Its public website can be accessed at www.acli.com.

[2] Based on recent information, insurers invest in excess of an estimated $250 billion in the subordinated tranches of structured securities.

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the solely principal and interest conditions, it would be reported at FV-NI. Should structured securities meet the three conditions, and considering that most life insurers' business models employ asset-liability-management, we believe many structured securities would meet the business model criteria to be classified as FV-OCI under the FASB's tentative C&M model. Despite the preceding, we interpret one of the conditions in the FASB's tentative model[3] to unjustly limit the securities that could be reported at other than FV-NI. Specifically, structured securities that are subordinate to the senior tranche could, after considering all possible scenarios, experience losses that are proportionately higher than the losses in the underlying collateral pool. As a result, FV-NI reporting would be required. For the reasons set forth in this letter, we believe subordinated tranches in our structured security portfolios should be considered to meet the solely principal and interest conditions in the tentative model and be allowed to be reported at either FV-OCI or AC based on an entity's business model and the characteristic of the instruments.

RECOMMENDATION AND REASONING

We recommend the FASB treat structured securities similar to other debt investments and consider them to meet the cash flow characteristics of solely principal and interest. The vast majority of the structured securities owned by ACLI members are comprised of underlying pools of collateral that would meet the solely principal and interest characteristics test because they primarily include bonds and/or loans. Although some structures contain derivatives, the derivatives are generally used to align the contractual interest cash flows of the collateral with the contractual interest cash flows of the structured securities issued. Because structured securities possess characteristics similar to other debt instruments, we do not believe a potential loss of principal and interest as a result of structured subordination should be a consideration when determining the proper classification and measurement of these investments; rather, credit exposure is more appropriately addressed in the financial instruments impairment model. We believe structured securities should be allowed to be evaluated for impairment by applying a similar impairment model as the model used for corporate bonds; otherwise, a corporate bond with the same credit rating and a similar level of exposure to credit risk as a structured security may be reported at FV-OCI and evaluated for impairment through the impairment model; yet the structured security would be required to be reported at FV-NI.

We have noted that the FASB's tentative model could result in the same tranche being reported inconsistently by one company versus another, depending on the time of purchase, given the tentative model requires the cash flow characteristics to be evaluated only upon purchase (i.e., generally not to be revisited if circumstances change after purchase). For example, if one company purchased a subordinate tranche at origination and another purchased the same tranche after the senior tranche was paid off (i.e., after receiving full payment of principal and interest), the first company (i.e., the company that purchased at origination) would likely be required to report the investment at FV-NI because the tranche could experience losses that are proportionately higher than the losses of the underlying collateral pool (i.e., it is a subordinated tranche); whereas, when the second company

[3] One of the characteristics included is: The exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments (for example, this condition would be met if the underlying pool of instruments were to lose 50 percent as a result of credit losses and **under all circumstances** the tranche would lose 50 percent or less). (**emphasis added**)

purchased the same tranche after the senior tranche was paid off, it would be considered the senior tranche (no longer subordinate because the prior senior tranche was extinguished) and would be allowed to report the tranche as FV-OCI or AC, depending on its business model. Although the underlying characteristics of the tranche and the underlying pool are exactly the same (i.e., provide contractual principal and interest cash flows) and assuming the business model is the same for both companies, the investment could be reported inconsistently from company to company depending on the performance and expectations of the underlying collateral pool at the time of purchase. As mentioned before, we do not believe that credit exposure should drive the C&M conclusions.

Classifying structured securities as fair value through net income may create an accounting mismatch with related life insurance liabilities, which are generally measured at something other than fair value through net income (e.g., a measurement similar to AC or possibly in the future current measurement through OCI). As a result, structured securities should be permitted to be classified and measured based upon an entity's business model. We also do not agree that short-term volatility in the fair value of structured securities should be reflected in net income when the gains or losses have yet to be realized through the sale of the security or recognition of an other-than-temporary impairment (i.e., per Topic 320, when an other-than-temporary impairment occurs, credit-related losses are recognized in net income with the remaining non-credit portion of the fair value adjustment reported in OCI). In current U.S. GAAP, Topic 320 in conjunction with ASU 2010-11, *Derivatives and Hedging: Scope Exception Related to Embedded Credit Derivatives,* structured securities are typically reported as fixed income securities at fair value with periodic fair value changes reported in OCI (i.e., available-for-sale securities under Topic 320). We support the current classification and measurement that allows for recording structured securities at FV-OCI or AC, as it is consistent with the debt-like characteristics of structured securities and the business models generally employed by insurers. We recognize that the application guidance for contractually linked instruments in IFRS 9 was drafted when IFRS did not allow FV-OCI as a classification and measurement alternative. Given both the tentative FASB and IASB C&M models now provide for FV-OCI, we believe the model for structured securities should allow FV-OCI for all structured securities where the business model is to hold to collect contractual cash flows and sell. The securities would still be reported at fair value (rather than fair value changes being reported in net income, they would be reported in OCI). Should the FASB decide to retain the tentative conclusions regarding structured securities and given the potential significant volatility in net income, we believe it will reduce insurers' desire to invest in these securities and unfavorably impact the structured security market, which relies on the availability of investors in the subordinated tranches.

Our ACLI member companies would be happy to discuss this matter with you and/or provide you any additional information to evaluate this topic. Should you have any questions or wish to discuss any of our comments, please feel free to contact me.

Sincerely,

Michael Monahan
Senior Director, Accounting Policy

cc: Sue Cosper, Technical Director