



May 15, 2013

Ms. Susan Cospers, Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

Re: File Reference No. 2013-220: *Exposure Draft-Financial Instruments-Recognition and Measurement of Financial Assets and Financial Liabilities*

Dear Ms. Cospers,

The Allstate Corporation (“Allstate”) appreciates the opportunity to provide comments on the Financial Accounting Standards Board’s (“FASB” or “Board”) Exposure Draft, *Financial Instruments-Recognition and Measurement of Financial Assets and Financial Liabilities* (“ED” or “Proposal”). As the nation’s largest publicly held personal lines insurer, offering both property-casualty insurance and life insurance, Allstate has a significant investment portfolio (i.e., approximately \$100 billion), which includes a variety of investments that would be impacted by the proposals in the ED.

We have been following the Board’s deliberations on the Financial Instruments projects and appreciate the significant effort on the part of the Board and the Staff to perform outreach with affected constituents.

Allstate supports the goal to converge U.S. GAAP financial instruments recognition and measurement (“classification and measurement” or “C&M”) accounting guidance with that of the IASB, but only if the proposed changes are an improvement to existing U.S. GAAP. The Board’s stated objective of the proposed C&M model is to provide more decision-useful information about an entity’s involvement in financial instruments, while reducing complexity. We believe certain aspects of the ED fall short of improving existing U.S. GAAP, providing more decision-useful information, and /or reducing complexity.

***Financial Liabilities – Non-conformity with Insurance Contracts Project***

Our primary concern with the Proposal is its inconsistent accounting and reporting for non-interest bearing bank deposits as compared to Property-Casualty (“P&C”) claim reserves in the Insurance Contracts proposal. Without question, non-interest bearing bank deposits possess greater inherent risk than P&C claim reserves. Historical illustrations of that risk exist in the S&L Crisis where the untimely exodus of deposit liabilities led to the untimely liquidation of illiquid assets, the erosion of capital, and ultimately to the demise of many savings and loan institutions. It also resulted in the need to increase FDIC guarantees to protect customer deposits. More recently, in the 2008 Credit Crisis, while not originally deposit liability driven, the same situation occurred as in the S&L Crisis where a lack of confidence led depositors to withdraw funds at higher than anticipated rates, leading to the untimely liquidation of illiquid assets, the erosion of capital, and ultimately to the demise of many financial institutions. In contrast, there is no comparative “run on the insurer” as P&C claim reserves,

unlike bank deposits, cannot be accelerated by policyholders and are settled through the normal claim adjustment process.

We do not disagree with the requirement in the Proposal to measure and report non-interest bearing bank deposits at nominal (i.e., undiscounted) amounts without probability-weighting. At the same time, given the significantly greater risk that non-interest bearing deposits pose to investors compared to P&C claim reserves, we do not understand why the Board would require P&C claim reserves to be measured at the present value of probability-weighted cash flows and not require the same accounting for the comparatively riskier non-interest bearing bank deposits. From an investor's perspective, it would clearly be more useful to have present valued probability-weighted estimates for liabilities subject to customer acceleration than for P&C claim reserves which are settled over time as the claim adjustment process evolves. In short, we do not believe P&C claim reserves and non-interest bearing demand deposits should be accounted for on an inconsistent basis. That is, either P&C claim reserves should be accounted for based on the model in the Proposal or non-interest bearing bank deposits should be accounted for at the present value of probability-weighted cash flows as set forth in the Insurance Contracts proposal.

Other aspects of the Proposal that generated the most concern relate to the contractual cash flow characteristics assessment ("CCA") and the business model assessment ("BMA"). In general, we believe the proposed C&M model places too much weight on the importance of the CCA (i.e., solely payments of principal and interest criteria or "SPPI"), relative to the BMA, in determining the C&M for financial assets.

#### ***Significance of SPPI Criteria-General Concerns***

A primary concern with the ED is the significant weight placed on the SPPI criteria and the fact that the SPPI criteria may result in significantly more financial assets for insurers being reported at fair value with periodic changes in fair value reported in net income ("FV-NI"). Specifically, should a financial instrument contain an insignificant contractual provision that does not meet the complex SPPI criteria, the entire instrument would be reported at FV-NI and all changes in fair value, whether or not they are expected to be realized, would be reported in earnings. The result of applying the SPPI test may be that similar financial assets managed under the same business model may be reported differently in the financial statements. This would decrease comparability and reduce the understandability of financial instruments accounting and reporting.

#### ***Application of SPPI Criteria-Equity Securities***

We believe the business model should be the determining factor for C&M so that financial assets managed under the same business model are accounted for consistently. For example, Allstate does not manage equity securities through a trading portfolio; rather, they are managed to mirror an index where securities are infrequently removed from the index and thus we do not believe the business model used to manage equities would be faithfully represented if all equities are reported at FV-NI. Also, given periodic market trends, equity volatility could be as large as 10%-20% in any given quarter. We do not see the relevance to an investor of reporting periodic mark to market changes in earnings when financial instruments are not managed under a business model whose objective is to capture short-term changes in value.

#### ***Application of SPPI Criteria-Beneficial Interests***

With regard to beneficial interests in securitized financial assets ("BIs"), we believe BIs should be evaluated similar to other fixed income instruments (e.g., corporate debt) to determine the appropriate

C&M. Contractually, BIs include payments of principal and interest, similar to a corporate bond. The source of the cash flows (i.e., how the cash flows are generated) is not relevant when evaluating the C&M for corporate bonds and we believe it should not be relevant when evaluating C&M for BIs. Similar to our comments regarding equity securities, if the business model for BIs is to collect cash flows and potentially sell the assets, they should be reported at fair value with periodic fair value changes reported in other comprehensive income (“FV-OCI”), similar to any other fixed income instrument.

### ***SPPI Test Increases Complexity***

Additional concerns we have with the proposed model include using the SPPI criteria to replace the existing “clearly and closely related” criteria in Topic 815 and the proposed elimination of the ability to bifurcate embedded derivatives from financial assets.

The existing guidance has been in place for many years and is tested and well understood. In addition, the Proposal retains the “clearly and closely related” guidance for financial liabilities and thus, we believe it should also be retained for financial assets for purpose of consistency.

We do not believe an instrument that fails the SPPI test should be required to be reported in its entirety at FV-NI; rather it should be bifurcated using the criteria in existing U.S. GAAP. We are concerned that embedded derivatives which represent only an insignificant portion of the fair value of a financial asset could be the determining factor for the C&M of a financial asset in its entirety, when the asset may be managed with a business model that is more consistent with FV-OCI or amortized cost (“AC”). We are also concerned about the increased restatement risk associated with the Proposal. More specifically, under the Proposal, should an instrument be erroneously determined as meeting or not meeting the SPPI test, the fair value changes of the entire instrument would be the measure of the potential misstatement and not just the value of the embedded. Consequently, we believe increased restatement activity by reporting entities would significantly reduce investors’ confidence in reported financial statements.

Should the Board decide to retain the SPPI criteria, we recommend adding a significance threshold. A significance threshold would reduce our concerns about the significant operational implications of applying the SPPI test. Should the Board not add such a threshold, we do not believe the SPPI test would be operational as reporting entities would need to review all contractual agreements at a very granular level which for portfolios with thousands of investments is not practical. On an on-going basis contractual agreements would need to be reviewed for all newly purchased investments.

In addition to modifying the SPPI criteria by incorporating a significance threshold; we recommend the SPPI criteria for BIs be modified so that the criterion, which focuses on exposure to credit risk in the underlying pool inherent in the tranche relative to the credit risk in the underlying pool, not require an evaluation of “all circumstances” to determine if the criterion is met. Conditions that are not expected to occur should not be the determining factor for classification and measurement.

### ***Business Model Recommendations***

Although we believe the BMA proposed in the ED to determine if an instrument would be classified and measured at FV-OCI or AC is reasonably articulated, additional clarification would be helpful. The ED does not explicitly address tainting. While tainting is not explicitly addressed in the ED, market practice may evolve to a point where tainting emerges as a specific outcome when applying the Proposal. To prevent this from occurring, we recommend the C&M be based on the “primary”

business model applied to a financial instrument. We also recommend similar language in proposed IFRS 9 guidance is added to the ED to clarify that certain sale activity if infrequent (even if significant) may still be consistent with the FV-OCI or AC business model.

We also recommend the ED explicitly address the “decision to sell” assets that are reported as FV-OCI. The ED does address intent to sell for assets reported at AC; however, it is silent with regard to FV-OCI assets.

***Other Recommendations***

Given the interaction of the C&M model with the Impairment project and Insurance Contracts project, we recommend the effective dates be aligned for all three projects. It would be confusing to users of financial statements to have staggered effective dates given the significant financial statement impacts of each of the projects and their interrelationship. We also believe if the Insurance Contracts project results in retrospective adoption, reporting entities should have the option to adopt certain aspects of the C&M model retrospectively to correct an accounting mismatch in prior reported periods. Given the operational implications of applying the SPPI criteria (e.g., evaluating all contractual provisions to determine if the SPPI criteria is met), we believe the effective date should be no earlier than 24 months from the time the guidance is finalized.

Please see our additional views regarding the proposed ED in the attached Appendix A. Should you have any questions or wish to discuss any of our comments, please contact either Kevin Spataro or Diane Bellas.

Kevin Spataro  
Senior Vice President, Corporate Accounting Research  
Allstate Insurance Company  
Ph: 847-402-0929

Diane Bellas  
Director, Corporate Accounting Research  
Allstate Insurance Company  
Ph: 847-402-5732

CC: Sam Pilch  
Group Vice President, Controller & Chief Accounting Officer  
Allstate Insurance Company

## APPENDIX A 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?

*We generally agree with the scope of the ED; however, once the scope of the Insurance Contracts project is finalized, we recommend the scope of the C&M ED be clarified to either include or exclude investment-type contracts from Topic 944 (e.g., single premium deferred annuities). At this time, it is not clear to us as to whether or not they were intended to be in scope of the Proposal. Our interpretation of the ED is that, if investment-type contracts are in scope of the proposal, they would be reported at AC and any embedded derivatives would be bifurcated with fair value changes in the derivatives reported in net income.*

*To further simplify the model, we believe if a financial asset or financial liability is short-term in nature and its carrying value is a reasonable estimate of fair value, a practical expedient should be allowed (i.e., report the instruments at carrying value). To require a reporting entity to evaluate and document the business model for such instruments and to estimate their fair values as other than carrying value would not be cost justified.*

**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?

*We agree with the retention of the industry-specific specialized guidance.*

### Recognition

#### *Questions for Users*

**Question 3:** The proposed amendments would require an entity to classify financial assets into the appropriate subsequent measurement category (that is, at amortized cost, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at fair value with all changes in fair value recognized in net income) on the basis of the contractual cash flow characteristics of the instrument and the business model within which financial assets are managed. Does the classification of financial assets based on the cash flow characteristics and the business model assessment provide decision-useful information? If yes, how will this classification influence your analysis of the entity? If not, why?

*As a significant investor and a significant user of financial statements, we are concerned that the application of the proposed model may reduce the decision-usefulness of financial statements. Specifically, it may result in an increase in the number and amount of financial assets reported at FV-NI as a result of the SPPI test, which may not be faithfully representative of how the company benefits from the cash flows from the affected financial assets. We believe the BMA should be the determinative factor when classifying and measuring financial assets and that the SPPI test should be replaced with existing U.S. GAAP requiring identification and bifurcation of embedded derivatives in situations where a compound instrument is identified. Additionally, the BMA should be based on the “primary” business model applied to financial assets. Focusing on the “primary” business model applied to financial assets would be more decision-useful as it would prevent fair value changes from being reported in net income (or OCI) when those fair value changes are not expected to be realized through a sale of a financial instrument.*

#### *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?

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*No. The proposed amendment does not appropriately convey the principle associated with the contractual cash flow characteristics assessment.*

### ***Weight Placed on the SPPI Test in the Proposal***

*One of our primary concerns related to the ED is that we do not believe that the SPPI test should be the determining factor in C&M of financial assets. Should a financial instrument not meet the SPPI criteria, the entire instrument is reported at FV-NI and all changes in fair value, whether or not they are expected to be realized, would be reported in earnings. We do not support such an approach because it adds complexity to understanding reported earnings in that instruments for which the same business model is applied may be reported differently in the financial statements. It also may add unwarranted volatility to reported earnings.*

### ***Equity securities***

*We do not manage equity securities through a trading portfolio (i.e., as defined in Topic 825 or FAS 115) and thus we do not believe a single business model of FV-NI for equities faithfully represents the business model of insurers for equities. Equity securities are primarily purchased to support capital growth in our property-casualty company. An equity portfolio of an insurer may be designed to mirror an index, where the names in the underlying index infrequently change and the assets are not managed to exploit short-term changes in share prices through frequent buying and selling. Periodic modifications to investment allocations may result in sales, however, the frequency of sales is significantly less than would occur in a trading portfolio. The Basis for Conclusions of the ED mentions that the reason equity securities are to be reported at FV-NI is because the only way to realize cash flows is through a sale. Although true (with the exception of on-going dividend cash flows), we do not understand the relevance of the statement to the overall C&M model. We urge the Board to consider the implications of reporting significant unrealized gains and losses on equity securities through earnings when those gains and losses may never be realized. We do not see how the proposed accounting would enhance the decision-usefulness of information reported to investors. When evaluating the business model we use to manage our equity securities, the assets would typically be more appropriately reported at FV-OCI because they are managed for collection of cash flows (i.e., dividends) or sales.*

### ***Beneficial Interests in Securitized Financial Instruments***

*Applying the SPPI criteria to BIs may result in the BIs being classified and measured inconsistent with their underlying business model. Insurers manage BIs similar to other fixed income instruments in that they are typically held for the collection of contractual cash flows or sale. The SPPI criteria would likely result in all subordinated tranches being reported at FV-NI instead of FV-OCI, which is inconsistent with the way they are managed. We discuss the criteria further in Question 9.*

### ***Recommend Bifurcation in Existing U.S. GAAP be Retained***

*We do not believe the SPPI test, which is in part intended to replace the “clearly and closely related” guidance in Topic 815, and the elimination of bifurcation is an improvement to existing U.S. GAAP. The existing guidance has been in place for many years and is well understood and tested. The proposed SPPI is untested and written using a principles based approach that may not produce consistent outcomes when applied to unique structures. The proposed model retains the “clearly and closely related” guidance for financial liabilities and thus, we believe to promote symmetry in accounting for financial assets and liabilities, the existing guidance should be retained for financial assets. Application of the SPPI test would provide less clarity than current U.S. GAAP, increase diversity in practice, and reduce the decision-usefulness of the financial statements. We are also concerned about embedded derivatives that only drive a portion (possibly insignificant portion) of the fair value of a financial asset and may be the determinative*

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*factor for C&M for an entire financial asset, when the asset may be managed pursuant to a business model that is more consistent with FV-OCI or AC.*

*We are also concerned about increased restatement risk associated with the SPPI test. Under existing guidance if a reporting entity fails to identify the existence of a derivative, the changes in the fair value of only the embedded derivative is evaluated to determine if financial statements should be restated. Under the Proposal, should an embedded derivative instrument not be identified, the fair value of the entire instrument would be evaluated to determine if a restatement is necessary. Given the SPPI proposal is untested, we believe the risk of failing to identify whether an asset passes or fails the SPPI test would be elevated and thus restatement risk would also be elevated. The SPPI test does not incorporate a significance threshold and thus even a small contractual provision that does not meet the SPPI criteria could render the entire instrument FV-NI.*

### ***If the Board Retains the SPPI Test***

*If the Board retains the SPPI test, we recommend the SPPI criteria be modified so that contractual terms of a financial asset are evaluated to determine if the contractual cash flows are “primarily” payments of principal and interest. Although we do not agree that the SPPI test should determine the classification of an entire instrument as FV-NI, adding a significance threshold would reduce our concerns that an insignificant contractual provision would result in an entire financial instrument being classified and measured at FV-NI. Incorporating a significance threshold into the SPPI criteria would also reduce our concerns that an insignificant contractual feature would be missed in the evaluation of the SPPI criteria.*

**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?

*We believe expanding the definition of “principal” would not adequately clarify the meaning of “or other settlement”. Rather than defining “principal”, the cash flow test would be clearer if the requirement was that at inception, the entity expects to recover substantially all of its initial net investment.*

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

*If the Board decides to adopt the SPPI test for BIs, we believe another illustrative example for a BI that is subordinated should be included in the final guidance to illustrate how the test would be applied to a tranche that is neither the residual BI nor the most senior BI.*

*It is unclear as to why a contractual feature where interest is paid on deferred interest is necessary to meet the SPPI test as illustrated in Instrument G of the ED. We believe that if the absence of a provision that pays interest on deferred interest is consistent with market terms, it should not be determinative for classification and measurement of a financial asset.*

**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?

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*We believe the “double-double” test for embedded derivatives in Topic 815 as well as the expectation that the investor would recover substantially all of its initial net investment are well understood concepts and a new test is not necessary.*

**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 noted in our response to Question 7, we prefer the existing “double-double” test and Topic 815 embedded derivatives guidance versus the SPPI test.*

**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 support the look-through concept; rather, the Proposal should base the AC or FV-OCI classification on the business model and if not substantially all of the initial net investment is expected to be recovered, an embedded derivative should be identified and bifurcated. If the SPPI test is retained, we believe there is no basis for treating BIs differently than any other fixed income security when assessing classification and measurement. The contractual terms are payments of principal and interest, just like a corporate bond, and thus BIs should be reported at either AC or FV-OCI depending on the business model used to manage the assets. A look-through should not be necessary to determine classification and measurement. Underlying cash flows are not evaluated when determining classification and measurement for corporate bonds and should also not be a consideration for BIs. If BIs are not treated similar to other fixed income instruments in the SPPI test, the subordinated BIs would likely be reported at FV-NI where the business model for managing the assets may be the same as for other fixed income instruments that would meet the SPPI test and be reported at FV-OCI or AC.*

*The ED has specific SPPI criteria related to subordination in BIs which is inconsistent with current U.S. GAAP. IASB staff has noted that the IASB included the subordination SPPI criteria for BIs in IFRS 9 because they concluded that subordination through tranching is analogous to the subordinated tranches selling credit protection to senior tranches, thus warranting derivative treatment (i.e., FV-NI). U.S. GAAP addresses BIs and subordination in Topic 815 and concludes that it does not warrant derivative accounting treatment. The topic has been evaluated many times over the past several years and most recently when the FASB issued ASU 2010-11, Scope Exception Related to Embedded Credit Derivatives. Each time the topic was evaluated, the FASB consistently concluded that cash flows that involve simple subordination do not warrant derivative accounting. We agree with the Board’s prior conclusions as we do not view subordination through a securitization structure to be any different than subordination that occurs through a corporation’s capital structure (e.g., senior debt, subordinated debt, mezzanine debt, equity, etc.).*

*Additionally, the look-through in the Proposal is not operational for many structures, especially without a significance threshold incorporated into the SPPI test (discussed further in Question 4). For example, collateralized debt obligations (“CDOs”) could include an underlying pool of other CDOs (i.e., CDO squared) which could render the look-through approach non-operational. Also, other securitizations may need to be evaluated individually to determine if the SPPI criteria have been met, which could involve the review of hundreds of contractual agreements for some investors.*

*We also believe the look-through in the Proposal should contain a significance threshold so that insignificant provisions do not require an entire instrument to be reported at FV-NI. For example, some collateralized debt obligations contain a provision that allows the investment manager to invest through selling credit protection under a written credit default swap (“CDS”). This allows the manager to assume credit risk on a temporary basis until the cash instrument is available in the market. The contractual provision usually provides that an insignificant percent of the underlying collateral may be in the form of a written CDS (i.e., less than 10%). Such an insignificant provision should not require the entire instrument*

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*to be reported at FV-NI. Adding a significance threshold would focus the classification and measurement on those features that are the primary features of an instrument.*

*Should the FASB decide to adopt the SPPI test for BIs as proposed, we urge the Board to modify the subordination criterion in the Proposal. The subordination criterion evaluates exposure to credit risk in the underlying pool that is inherent in the tranche held by an investor versus the credit risk in the underlying pool. We recommend that the evaluation be modified to not require the subordination criterion to be evaluated under “all circumstances” so that the final classification and measurement of a financial asset is based on the primary provisions of the instrument (i.e., conditions that are not expected to occur would not drive the classification and measurement of the instrument).*

**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 BMA in all cases. We believe the restrictions that result from application of the SPPI test would in some cases cause financial instruments to be classified and measured at FV-NI where such classification and measurement would be inconsistent with the business model. This is further exacerbated by the fact that FV-NI is the “default” measurement category under the Proposal. We support an approach that would use the business model to define the criteria for classifying and measuring financial assets at AC or FV-NI and designate FV-OCI as the “default” category. We believe that financial instruments should receive the FV-NI or AC designation based on the underlying business model of selling to manage changes in short-term market movements or holding to collect cash flows. The default designation is FV-OCI when the business model is hold to collect cash flows and/or sell.*

*The ED does not explicitly address a tainting notion; rather the FASB relies on the principles conveyed in the ED together with professional judgment. While tainting is not explicitly addressed, market practice may evolve to create a tainting threshold. To prevent this from occurring, we recommend the BMA be based on the primary business model applied when managing a financial instrument. We also believe, given the ED states that an “...entity should consider pertinent historical experience, such as historical sales of financial assets and the reasons for them” that significant weight may be placed on historical transactions and if an entity sold instruments classified and measured at AC in the past for an unacceptable reason, the reporting entity may be prevented from applying AC to those asset types in the future. We believe transactions that occur that are not aligned with the business model, as long as they are rare, should not call into question the business model being applied. We suggest the FASB consider the following language in IFRS 9 be incorporated into the ED:*

*“ Sales that occur for other reasons may also be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if such sales are infrequent (even if significant) or insignificant both individually and in aggregate (even if frequent).”*

*We believe this language would allow the business model to be determined based on the primary business of a reporting entity.*

**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?

*The application guidance and illustrations are sufficient.*

**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?

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*See answer to Question 10. We believe further clarification is warranted.*

**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?

*We agree that the loan commitment accounting should follow the loan accounting, but only if the AC conditions are relaxed. If the business model is not changed to allow the occasional sale of a loan for a reason other than credit deterioration of the specific loan, many loan commitments would be carried at FV-OCI (as the probability of exercise may be higher than remote).*

### Initial Measurement

*Questions for All Respondents*

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

*We agree that the initial measurement principles for financial assets classified as AC or FV-OCI should be based upon the transaction price and do not object to the initial measurement principles of fair value for assets classified at FV-NI.*

### Subsequent Measurement

*Questions for Users*

**Question 15:** The proposed amendments would eliminate the unconditional fair value option (for financial instruments within the scope of this proposed guidance) in existing U.S. GAAP and, instead, permit an entity to elect to measure at fair value, with all changes in fair value recognized in net income, all of the following:

- a. A group of financial assets and financial liabilities if the entity both:
  1. Manages the net exposure relating to those financial assets and financial liabilities (which may be derivative instruments) on a fair value basis
  2. Provides information on that basis to the reporting entity's management.
- b. Hybrid financial liabilities that meet certain prescribed criteria.
- c. Financial assets that meet the contractual cash flow characteristics criterion and are managed within a business model that has the objective of both holding financial assets to collect contractual cash flows and selling financial assets (in accordance with paragraph 825-10-25-25(b)).

Do these options provide decision-useful information? If not, why?

*We believe a reporting entity should be able to use the fair value option when correcting an accounting mismatch (e.g., classification and measurement of financial assets do not match the classification and measurement of financial liabilities). We also believe if an accounting mismatch exists and reporting an AC asset at FV-OCI would correct that mismatch, the fair value option should allow the asset to be reported at FV-OCI. This approach is very important for insurance companies where the insurance contracts project could result in discount rate changes for insurance contract liabilities being reported in OCI.*

*As previously mentioned, we believe current bifurcation rules associated with financial assets should be retained.*

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*The meaning of managed on a “net exposure basis” and the level of management that information must be provided to is unclear.*

*Questions for All Respondents*

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

*We agree with the subsequent measurement criteria for financial liabilities. We believe the same facts and circumstances and the same logic should apply to the accounting and reporting of P&C claim reserves. If the Board does not agree with the consistent reporting of financial liabilities as proposed in the ED and P&C claim reserves, we believe more intuition should be provided about why present value probability-weighted cash flows are necessary for P&C claim reserves and not for non-interest bearing demand deposit liabilities.*

**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?

*Yes.*

**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?

*We agree with the proposed requirements to measure AC assets at amortized cost less impairment when those assets are subsequently identified for sale. We also agree with prohibiting recognition of a gain until the sale is complete.*

*As mentioned previously, we also recommend the Board explicitly address intent to sell for FV-OCI assets. See our answer to Question 10.*

**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?

*We do not agree that temporary declines in fair value should be recognized in reported earnings as they may reverse in the future. We believe, if an entity is applying the Proposal, adding another step to the impairment process to determine if the impairment is other-than-temporary would be appropriate.*

**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 with the proposal to evaluate the need for a valuation allowance on deferred tax assets (“DTAs”) related to debt instruments in an unrealized loss position separately from other DTAs. That approach is an acceptable approach in existing U.S. GAAP and is theoretically sound. We would, however, recommend, that the wording in the ED be modified to clearly state that, as long as a reporting entity has the intent to*

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*hold unrealized loss debt instruments until recovery, that intent can be used as a tax planning strategy to substantiate that there is no need for a valuation allowance on the related deferred tax asset.*

**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?

*We do not agree. See our prior responses to Question 4.*

**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 agree that reclassifications would typically be rare and that the reclassification should occur on the last day of the quarter that the decision was made by management to reclassify. We do not agree with the IASB proposal that reclassifications should be recorded on the first day of the subsequent quarter.*

*We recommend that the business model determination be based on the primary business model for the financial instruments. As mentioned previously, there may be unforeseen circumstances where assets in the AC category are sold for appropriate portfolio management reasons. These transactions/re-alignments would not be frequent and should not call into question the business model for the assets and should not require reclassification or a future restriction on the use of the AC designation.*

*With regard to the reclassification mechanics described in the proposal, there are certain mechanics that we recommend be further clarified. The specific scenarios and suggested modifications are as follows:*

- Assets measured at FV-NI are reclassified to the FV-OCI business model and changes in unrealized after the transfer are reported in OCI. The guidance should clarify that fair value at the time of transfer is the new amortized cost (and thereafter should be accreted or amortized).*
- Assets measured at FV-OCI are reclassified to a business model of AC and the fair value at the time of transfer is to be the carrying value from that point forward; however, the OCI is supposed to be reversed. We believe any amounts in OCI at the time of the reclassification should be locked in as a basis adjustment and not reversed.*

### **Presentation**

#### *Questions for Users*

**Question 23:** The proposed amendments would require public entities to parenthetically present fair value for items measured at amortized cost on the face of the statement of financial position. Does that presentation requirement provide decision-useful information? If not, why? What would you propose instead?

*For the insurance companies we analyze, a significant portion of their assets are already reported at fair value because of the business model used to manage the assets.*

*With regard to providing fair values parenthetically for those instruments where their business model is neither FV-NI nor FV-OCI, we do not agree with such a proposal. Reporting fair values on the face of the financial statements implies that the values are relevant to managing an insurer's business, when they are*

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*not relevant. We recommend the fair values be disclosed in the notes to the financial statements as they are today.*

**Question 24:** The proposed amendments would exempt nonpublic entities from parenthetical and footnote disclosures of fair value. Should nonpublic entities be required to parenthetically present fair value information on the face of the statement of financial position for financial instruments measured at amortized cost? If not, should fair value disclosures in notes to the financial statements be required for some or all nonpublic entities for financial instruments measured at amortized cost?

*We see no valid reason for non-public companies not to provide this information.*

**Question 25:** The proposed amendments would require an entity to separately present changes in fair value attributable to changes in instrument-specific credit risk in other comprehensive income for financial liabilities for which that entity has elected the fair value option. Would the proposed presentation requirement provide decision-useful information? If not, why? What would you propose instead?

*We agree with the presentation as proposed. We do not agree with the counter-intuitive results when an entity's own credit risk either declines or improves and the impact that it has on the income statement. Segregating such impacts in OCI rather than net income is less confusing to a user.*

### *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 understand that the reasoning for this proposal includes an assumption that all foreign currency risk would be hedged and thus, reporting the changes in fair value for debt instruments that are attributable to exchange rates in net income would be offset by the changes in the fair value of the hedge. However, if the exchange rate changes are not hedged, we do not agree that temporary changes in exchange rates that may never be realized should be reported in net income.*

### **Disclosures**

#### *Questions for Users*

**Question 27:** The proposed amendments would require a public entity to provide disclosure of the core deposit liability balance, implied weighted-average maturity period, and the estimated all-in-cost-to-service rate by significant type of core deposit liability. Do you agree with the proposed disclosure requirement and, if so, how would you use that information? If not, what information should be provided and why? Is it appropriate not to require this information for nonpublic entities?

*We would like to understand why the Board took this approach for non-interest bearing bank deposits and a completely different approach for insurance liabilities. Intuitively, it would appear from an investor's perspective that it would be more important to have present value probability-weighted estimates of liabilities that are subject to discretionary customer withdrawal at any time for any reason versus P&C claim reserves which are settled over time as the claim adjustment process evolves. We do not believe P&C claim reserves and bank non-interest bearing demand deposits should be accounted for on an inconsistent basis. However, if inconsistent accounting is necessary, it would appear more useful and necessary to have bank non-interest bearing demand deposits use the discounted probability-weighted cash flow model versus P&C claim reserves to apply the model outlined in this Proposal.*

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**Question 28:** Are there any other disclosures that would provide decision-useful information and why?

*None.*

*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 note that similar to other FASB proposals, the disclosure requirements in the ED are for both interim and annual reporting and we are concerned about the operational implications of such a requirement. Interim disclosures should only be required if there have been significant changes since the reporting entity disclosed annual information, similar to the approach used by the SEC for the MD&A. Continued increases in interim reporting requirements adds significant pressure to the quarterly reporting process and jeopardizes filing deadlines for public companies. We urge the Board to modify their approach and only require interim disclosures when significant changes have occurred from the already reported annual 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?

*No.*

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

*Yes.*

*Questions for Preparers and Auditors*

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

*Implementation would involve an evaluation of all types of financial instruments, including review of contractual terms in order to apply the SPPI test. The review could involve thousands of contracts and also would require systems changes for instruments such as equity securities as well as additional documentation requirements for the CCA and BMA. Therefore, implementation time should be at least 24 months.*

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

*As drafted, we do not believe the SPPI test is operable.*

### **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

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held for sale at initial recognition. Are the proposed indicators/conditions operable? If not, why? What would you propose instead?

*If an investment is held for sale, we believe any losses expected to be incurred upon sale should be recognized when the decision is made to sell (consistent with ASC 420).*

*We do not support the current language in the ED where equity method investments would be considered held for sale if the investor has identified potential exit strategies and the investor has a defined time at which it expects to exit the investment. The contractual agreements for many insurance company investments for which equity method is applied include estimated liquidation dates for the investee. We believe such provisions could be considered exit strategies or defined times to exit investments. We believe the Proposal was intended to identify instruments where the investor expects to exit the investment prior to the liquidation of the equity method investee and thus we believe the language should be modified to clarify this intent. Otherwise, a significant number of assets for which an investor intends to hold until liquidation could be incorrectly reported as held for sale.*

*Also, we do not agree with the Proposal in that it eliminates the cost method under APB 18 and provides a practicability exception to report the instruments at FV-NI (i.e., cost less impairment plus or minus observed prices changes on an identical or similar instrument from the same issuer). Similar to other equity type investments, the Board notes that the instruments should be reported at FV-NI because the amounts can only be realized upon sale (no contractual payments due). We do not agree with this approach for cost method investments because they are intended to be held for the long-term. The markets for such instruments are illiquid and thus it is rare that they are sold. The investments are held for the collection of cash flows, which include cash flows that are returns of principal and income cash flows. The business model applied to these instruments is consistent with either an AC or FV-OCI business model and thus should be reported in that manner.*

**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 recommend the impairment of equity method and other equity instruments be addressed in the Impairment project, not the C&M project.*

*We do not agree with the proposal to eliminate the other-than-temporary step when assessing impairments on equity method or other equity instruments as it could result in temporary declines in value, which may never be realized, being reported through the income statement.*

**Question 36:** Do you agree that the current portfolio-wide option for not-for-profit entities, other than health care entities, to account for their equity method investments at fair value should be retained? If not, why? Should that option also be made available to not-for-profit health care entities that are within the scope of Topic 954, Health Care Entities?

*Not applicable.*

### **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

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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?

*As already discussed, we believe symmetry should exist in applying the bifurcation guidance. It should be applied to both liabilities and assets. To introduce the SPPI test for financial assets while retaining bifurcation concepts for financial liabilities adds complexity to the C&M model and is not decision-useful.*

*We agree that the fair value option should be allowed for financial liabilities that have an embedded derivative. We also agree that bifurcation should be retained for financial liabilities.*