



May 30, 2013

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

Re: File Reference No. 2012-260: *Exposure Draft-Financial Instruments-Credit Losses*

Dear Ms. Cospers,

The Allstate Corporation ("Allstate") appreciates the opportunity to comment on the Financial Accounting Standards Board's ("Board's") Exposure Draft, *Financial Instruments- Credit Losses* ("Proposal"). As the nation's largest publicly held personal lines insurer, offering both property-casualty ("P&C") insurance and life insurance, Allstate has a significant investment portfolio (approximately \$100 billion) that includes both debt securities (approximately \$76 billion) and loans (approximately \$8 billion).

The Board's objective in the Proposal is to provide guidance on how to recognize and measure expected credit losses on the basis of an entity's current expectations about the collectibility of contractual cash flows. The principal catalyst for the Proposal was criticism of the existing "incurred" loss model and that it recognized credit losses that were "too little and too late" during the financial crisis. In response, the Proposal introduces an "expected" credit loss model designed to accelerate the recognition of potential future credit losses based on management's current expectations about the future.

Despite criticism coming out of the financial crisis, we do not believe reported earnings should include credit loss estimates based on events that have not yet occurred, and may never occur, as this information would be neither comparable between reporting entities nor decision-useful. In contrast, we believe the needs of investors are better served if preparers recognize credit losses based on facts and circumstances that support that credit impairment has occurred at the reporting date. Moreover, we do not believe the "too little and too late" criticism applies to debt securities because the credit loss model for debt securities has already been modified as a result of the financial crisis and results in the timely recognition of credit losses based on actual, verifiable facts and circumstances.

#### ***Projecting Future Expected Losses-Insurance Contracts and Financial Instruments***

We do not believe introducing into reported earnings subjective projections of possible future events that have not yet occurred provides more comparable, decision-useful information to investors than an incurred loss model based on actual events that are subject to validation. Accordingly, replacing the existing incurred loss framework with an expected loss framework would not be an improvement to existing U.S. GAAP.

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The credit loss Proposal would replace the existing incurred credit loss model for financial instruments that relies on actual events, facts and circumstances to determine if a credit loss has occurred. The current model employed for debt securities, commercial mortgage loans and bank loans involves the continuous monitoring of all available information on an individual asset basis where all facts and circumstances are thoroughly evaluated by experienced credit analysts together with management oversight to determine if an impairment exists and whether it is an other-than-temporary impairment (“OTTI”).

The current process is supported by robust Sarbanes-Oxley controls that ensure controls are appropriately designed and tested to support that controls are functioning as designed. External facts and circumstances, publicly filed financial statements, and other information is also used to facilitate individual asset monitoring to determine whether an OTTI exists at the financial reporting date. The Proposal would replace the existing robust process based on actual information with management’s subjective projections of future conditions. We do not believe the Proposal would result in more reliable projections of credit losses than the current model that is based on actual facts and circumstances that are subject to verification and therefore will not better serve the needs of investors.

As a point of similarity in the Insurance Contracts project, the Board has proposed a version of expected losses in the form of probability-weighted cash flows (“PWCFs”) that would replace incurred losses determined by claim adjusters who adjust actual claims with expected losses determined using statistical models at the financial statement date. We do not support the migration from incurred losses with its inherent rigor and connection to actual claims to expected losses with its focus on statistical models that are far removed from actual loss data. Our concerns are important as claim reserves represent the most critical and complex estimate in a P&C insurer’s financial statements and deficient loss reserving, which can also lead to inadequate pricing, is the leading cause of insolvencies of P&C insurers.

The Insurance Contracts proposal would replace an existing reserve estimation framework that relies on claim adjusters in the field who provide information about actual incurred losses to trained actuaries who compile the granular determinations and apply actuarial judgments and methods to determine the total amount of recorded claim reserves. In contrast, the expected loss based proposal in the Insurance Contracts project would consider a range of scenarios to which judgmentally based probability weights would be assigned to compute a mathematical estimate of expected losses. We believe this would generate periodic estimates of the most critical measurement in a P&C insurer’s financial statements that are not comparable or decision-useful.

We do not believe the PWCF-based expected loss proposal would produce more comparable or decision-useful information for investors than the current incurred loss approach determined by trained claim adjusters and aggregated by experienced actuaries to develop periodic estimates of total claim reserves.

***Debt Securities Should be Excluded from the Scope of the Proposal***

Should the Board nonetheless decide to adopt the Proposal, debt securities should not be included in the scope. The credit loss model for debt securities was already modified as a result of the financial crisis and results in the timely recognition of credit losses at amounts that are appropriate.

***Other Recommendations***

Given the interaction between the Financial Instruments projects (i.e., both Impairment and Classification & Measurement) and Insurance Contracts, we recommend the effective dates for all three projects be aligned. This would facilitate the most transparently integrated financial statements.

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.

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## APPENDIX A – QUESTIONS FOR RESPONDENTS

### Scope

*Question for All Respondents*

**Question 1:** Do you agree with the scope of financial assets that are included in this proposed Update? If not, which other financial assets do you believe should be included or excluded? Why?

*If the FASB adopts the expected cash flow model in the Proposal, we recommend that it exclude debt securities and financial assets that are short-term in nature (e.g., reinsurance recoverables, short-term investments, etc.).*

*Debt securities should be excluded for the following reasons:*

- The stated objective of the Proposal is to provide more decision-useful information about expected credit losses on financial assets. The existing framework, revised after the financial crisis, has worked well to identify appropriate amounts of credit losses in a timely manner. Moreover, the “too little and too late” criticism related to credit losses recognized pre-financial crisis was primarily directed at loans and not debt securities. As an insurer, a significant portion of our investment portfolio is allocated to debt securities and users of our financial statements have not expressed concerns about the timing or amount of credit losses recognized in our financial statements.*
- The existing credit loss model was modified post-financial crisis and we believe no further modification is needed. Revisions were made to Topic 320 which eliminated the probable threshold, thus resulting in the more timely recognition of losses.*
- The credit loss monitoring approach used for debt securities differs from the approach used for bank consumer loans, which justifies applying a different credit loss model to debt securities. Debt securities are monitored on an individual basis to determine if losses are OTTI. A significant amount of public information (e.g., period financial statements, 8-K filings, news releases, etc.) is available for individual public bonds and that information is used to monitor for OTTI. Similarly, a significant amount of information (e.g., periodic financial statements) is also available and can be used to monitor privately issued debt.*
- Given the existing credit loss model for debt securities is effective, we do not believe the benefits associated with adopting the Proposal outweigh its costs. The Board stated that the Proposal is expected to recognize losses earlier than under the existing impairment model. More specifically, moving from an incurred loss model to an expected loss model would result in the recognition of future events and conditions before they emerge or are otherwise reliably estimable. In evaluating the Proposal, Allstate estimated that the loss allowance for debt securities could be as little as 1% or less of the carrying value of the securities. If the Proposal was in place during the financial crisis, the loss allowance would have increased prior to actual losses being incurred; however, it would not have anticipated the “unexpected” losses that emerged and therefore would not have produced materially more timely or decision-useful information than that produced by our incurred loss model. The individual impairment approach currently employed to monitor debt securities is effective at identifying, measuring, and recording credit losses in a timely manner. Moreover, the operational costs of the Proposal would be significant as insurers do not have pooled impairment credit monitoring and estimation processes in place for debt securities and thus these processes would need to be designed, controls implemented, audited, and maintained on an on-going basis.*

*A practical expedient (i.e., an alternative to the expected loss model) should be allowed for the proposed impairment model if a reporting entity concludes that expected losses for financial assets expected to mature in less than one year are insignificant. The cost of implementing a process to estimate expected credit losses for short-term financial assets where losses are expected to be insignificant, along with a robust control framework, would significantly outweigh the benefits.*

*Should the FASB decide to include debt securities in the Proposal, we recommend modifications be made to the practical expedient for financial assets reported at fair value with periodic fair value changes reported in other comprehensive income (i.e., FV-OCI). See our answer to Question 14.*

## **Recognition and Measurement**

### *Questions for Users*

**Question 2:** The proposed amendments would remove the initial recognition threshold that currently exists in U.S. GAAP and, instead, view credit losses as an issue of measurement as opposed to an issue of recognition because the credit losses relate to cash flows that are already recognized on the balance sheet. Do you believe that removing the initial recognition threshold that currently exists in U.S. GAAP so that credit losses are recognized earlier provides more decision-useful information?

*We believe removing the probable threshold that currently exists for loans would provide more decision-useful information. Existing guidance for debt securities excludes an initial recognition threshold and has resulted in timely recognition of losses. We believe a consistent approach should be applied to loans and debt securities.*

*We support the existing incurred loss model for both debt securities and loans, which is triggered by the emergence of specific facts and circumstances. We believe an incurred loss approach should also be used in the measurement of P&C claim reserves as described in our cover letter. The existing incurred loss model reduces the amount of unverifiable subjective judgments when recognizing credit losses. In contrast, the Proposal requires the use of significant subjective judgments which will not produce comparable credit loss estimates between companies. As a result, we do not believe the Proposal is an improvement to the existing incurred model in U.S. GAAP and do not believe it meets the needs of investors.*

**Question 3:** As a result of the proposed amendments, the net amortized cost on the balance sheet (that is, net of the allowance for expected credit losses) would reflect the present value of future cash flows expected to be collected, discounted at the effective interest rate. Do you agree that the net amortized cost (which reflects the present value of cash flows expected to be collected) results in more decision-useful information than currently exists under U.S. GAAP?

*The question here is whether credit losses should be recognized on a present value basis. We believe the answer is yes in that both the amortized cost and the related allowance for expected credit losses would be reported on a consistent basis (i.e., on a present value basis).*

**Question 4:** The Board has twice considered credit loss models that would permit an entity not to recognize certain expected credit losses. In the January 2011 Supplementary Document, the Board considered a model that would permit an entity not to recognize some credit losses expected to occur beyond the foreseeable future. In the recent discussions on the three-bucket impairment model, the Board considered a model that would permit an entity only to recognize lifetime credit losses for loss events expected to occur within a 12-month horizon. Instead, the proposed amendments would require that at each reporting date an entity recognize an allowance for *all* expected credit losses. Do you believe that recognizing *all* expected credit losses provides more decision-useful information than recognizing only *some* of the expected credit losses? If not, how would you determine which expected credit losses should not be recognized (for example, 12 months or similar foreseeable future horizon, initial recognition threshold, and so forth)?

*We support an incurred loss model that uses a 12 month time horizon. In large homogeneous pools of loans this requires the application of techniques to estimate and recognize losses that have been incurred but have yet to be specifically identified. The twelve month guideline should be modified for loans with a shorter operating cycle (e.g., credit card loans) and for special facts and circumstances affecting groups of loans where reliable information exists indicating that losses may be incurred but will not be identified within 12 months. Notwithstanding our views on loans, we believe the existing model for debt securities which evaluates securities on an individual basis is effective and should be retained.*

**Question 5:** The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets' remaining contractual cash flows. Do you believe that expected credit losses based on this information provide decision-useful information?

*Yes, if applied within the guidance of our response to Question 4.*

**Question 6:** For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be amortized into and recognized as interest income over the life of the asset. To achieve this result, upon acquisition the initial estimate of expected credit losses would be recognized as an adjustment that increases the cost basis of the asset. Apart from this requirement, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you believe that using the same approach to recognize changes in the credit impairment allowance for purchased credit-impaired assets and non-purchased-credit-impaired assets provides decision-useful information? Do you believe that this is an improvement from the current model used for purchased credit-impaired assets?

*We do not believe the proposed reporting of purchase-credit-impaired assets is an improvement over current U.S. GAAP. We do not support the reflection of accounting adjustments to the basis of acquired assets that result in the recognition of interest income that is different from the elements of the acquisition transaction.*

**Question 7:** As a practical expedient, the proposed amendments would allow an entity not to recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost amount of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. The proposed amendments would require an entity to disclose the amortized cost basis of assets that apply this practical expedient each period. Do you believe that the practical expedient for some financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income is reasonable? Why or why not?

*We believe the practical expedient is only operable if either of the criteria is present (i.e., not both).*

**Question 8:** The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this approach provides decision-useful information?

*We do not believe the Proposal would produce decision-useful information, especially for debt securities where existing U.S. GAAP measures OTTI on a discounted basis and the net carrying value (after a write-down) is accreted back to the expected cash flows and the accretion is reported as investment income. We believe this approach provides more decision-useful information about interest income.*

*Questions for Preparers and Auditors*

**Question 9:** The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets' remaining contractual cash flows. Do you foresee any significant operability or auditing concerns or constraints in basing the estimate of expected credit losses on such information?

*The Proposal would increase both the operational costs and the audit costs associated with measuring, recognizing, and reporting credit losses while reducing comparability and the decision-usefulness of the resulting information. Although the Proposal could be operationalized, we do not believe introducing a significant amount of subjective judgment into reported earnings through management's projections of future expected credit losses would be an improvement. It would also introduce subjective projections into reported earnings that are not protected by Safe Harbor rules, which would be more appropriately reported in the MD&A.*

*Also, see our answer to Question 1 regarding costs outweighing benefits of applying the Proposal to debt securities and Question 2 about our support of the incurred loss model.*

**Question 10:** The Board expects that many entities initially will base their estimates on historical loss data for particular types of assets and then will update that historical data to reflect current conditions and reasonable and supportable forecasts of the future. Do entities currently have access to historical loss data and to data to update that historical information to reflect current conditions and reasonable and supportable forecasts of the future? If so, how would this data be utilized in implementing the proposed amendments? If not, is another form of data currently available that may allow the entity to achieve the objective of the proposed amendments until it has access to historical loss data or to specific data that reflects current conditions and reasonable and supportable forecasts?

*We believe an incurred loss model should be retained. Reporting entities have access to historical loss information and could gain access to external data of varying quality and specificity to project future expected credit losses. Our concern is that projections of the future by their nature are highly subjective. Accordingly, it would not be expected that comparable estimates of future conditions will be achieved unless the Proposal contains very prescriptive guidance which we do not believe will be the case.*

**Question 11:** The proposed amendments would require that an estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results. This proposal would prohibit an entity from estimating expected credit losses based solely on the most likely outcome (that is, the statistical mode). As described in the Implementation Guidance and Illustrations Section of Subtopic 825-15, the Board believes that many commonly used methods already implicitly satisfy this requirement. Do you foresee any significant operability or auditing concerns or constraints in having the estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results?

*We support estimating credit losses as the loss we expect to incur based on all facts and circumstances available at the time for both debt securities and loans. Given we manage debt securities individually and monitor credit losses on an individual instrument basis; we have adequate credit specific financial information from which to develop a reasonable estimate of credit losses. Our investment portfolio also contains various*

*loans, including bank loans and commercial mortgage loans, where we also have adequate credit specific information and, as a result, monitor these investments on an individual instrument basis. Introducing a model that requires subjective groupings and probability of loss and a probability of no loss estimates would not be an improvement over the existing approach and would not produce more decision-useful information for investors.*

**Question 12:** The proposed amendments would require that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly. Methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of the amortized cost amount written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic to the amortized cost balance as of the reporting date to estimate the portion of the recorded amortized cost basis that is not expected to be recovered because of credit loss. Such methods may include loss-rate methods, roll-rate methods, probability-of-default methods, and a provision matrix method using loss factors. Do you foresee any significant operability or auditing concerns or constraints with the proposal that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly? If time value of money should not be contemplated, how would such an approach reconcile with the objective of the amortized cost framework?

*We believe all measurements should be explicit as opposed to implicit for purposes of comparability. Moreover, this issue is already addressed in existing Topic 320 (i.e., FSP FAS 115-2), where OTTI on debt instruments is calculated on a present value basis and the net carrying value is accreted to future projected cash flows with accretion reported in investment income. If the non-accrual guidance in the ED is modified, it would present issues for preparers and investors.*

**Question 13:** For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be recognized as interest income. Apart from this proposal, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for expected credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you foresee any significant operability or auditing concerns or constraints in determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition?

*We do not support the estimation and recognition of an implied loss allowance for purchased credit impaired ("PCI") assets as this would gross up the balance sheet and potentially skew key performance indicators that are based on reserve levels. Assets should be reported at inception at the amount paid and should not be grossed up for an estimate of credit losses.*

**Question 14:** As a practical expedient, the proposed amendments would allow an entity to not recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost basis of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. Do you foresee any significant operability or auditing concerns or constraints in determining whether an entity has met the criteria to apply the practical expedient or in applying it?

*We do not support including debt securities in the scope of the ED as discussed in Question 4.*

*However, if the Board decides to include debt securities in the scope, we recommend the practical expedient be modified as discussed below.*



*We do not believe the practical expedient would minimize the cost of compliance when expected credit losses are insignificant for FV-OCI assets, which the FASB mentions in the Basis for Conclusions as one of the key reasons it introduced the practical expedient. We believe general market interest rate risk volatility could lead to a failure of the practical expedient and therefore believe it should be modified where if either of the criteria is met, the practical expedient may be applied. This would allow financial instruments, already reported at fair value, to avoid establishment of a loss allowance if expected losses are insignificant or if the financial instrument has a fair value that is greater than its amortized cost.*

**Question 15:** The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this proposal will change current practice? Do you foresee any significant operability or auditing concerns with this proposed amendment?

*See our response to Question 12.*

#### *Questions for All Respondents*

**Question 16:** Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45–BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor’s effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

*We do not believe the distinction between a troubled debt restructuring (“TDR”) and nontroubled debt restructuring is relevant because, under existing U.S. GAAP, similar to any other incurred loss, when a concession has been granted that results in a loss to the investor, a credit loss is recognized. We believe reporting TDRs separately from all other credit losses is unnecessary.*

## **Disclosures**

#### *Questions for Users*

**Question 17:** Do you believe the disclosure proposals in this proposed Update would provide decision-useful information? If not, what disclosures do you believe should (or should not) be required and why?

*We believe interim disclosures should only be required if there have been significant changes since the annual disclosures were reported. This would allow users to focus attention on only the most important financial developments since year-end reporting.*

#### *Questions for Preparers and Auditors*

**Question 18:** Do you foresee any significant operability or auditing concerns or constraints in complying with the disclosure proposals in the proposed Update?

*We note that similar to other FASB proposals, the disclosure requirements in the Proposal 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.*

*We are also concerned about the risk associated with disclosing management's expectations about the future in footnotes. We believe that information is better reported in the MD&A where it is protected by Safe Harbor rules.*

## **Implementation Guidance and Illustrations**

*Questions for All Respondents*

**Question 19:** Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient? If not, what additional guidance or examples are needed? 10

*Should the FASB include debt securities in the scope of the Proposal, we believe an illustrative example for a debt security would be helpful (e.g., beneficial interests in securitized financial assets).*

## **Transition and Effective Date**

*Questions for All Respondents*

**Question 20:** Do you agree with the transition provision in this proposed Update? If not, why?

*Yes.*

**Question 21:** Do you agree that early adoption should not be permitted? If not, why?

*Yes, we agree as we believe all reporting entities should adopt at the same time to promote comparability.*

**Question 22:** Do you believe that the effective date should be the same for a public entity as it is for a nonpublic entity? If not, why?

*Yes.*

*Questions for Preparers and Auditors*

**Question 23:** Do you believe that the transition provision in this proposed Update is operable? If not, why?

*Yes; however, applying the transition provision to debt securities would be operationally challenging as all credit losses recorded in prior periods were recorded as adjustments to carrying value and would need to be reversed. Additionally, income recognition for prior periods, including accretion to future projected cash flows, would need to be reversed and the proposed non-accrual guidance would need to be applied.*

**Question 24:** How much time would be needed to implement the proposed guidance? What type of system and process changes would be necessary to implement the proposed guidance?

*Given the interaction among the Impairment project, the Classification & Measurement project and the Insurance Contracts project, we recommend the effective dates be aligned for all three projects. Should the FASB decide to include debt securities in the scope of the Proposal, the application of the transition provisions would be significant in addition to creating an estimation process for loss allowances that does not currently exist. We would recommend at least a 24 month implementation period after adoption.*