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Technical Director – File Reference No. 2013-220
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Via E-mail:
Attn: director@fasb.org
File Reference No. 2013-220

Re: Proposed Accounting Standards Update on Financial Instruments-Overall (Subtopic 825-10) – *Recognition and Measurement of Financial Assets and Financial Liabilities*

Dear Sir or Madam:

The Travelers Companies, Inc. (Travelers) appreciates the opportunity to comment on the Financial Accounting Standards Board's (the FASB or the "Board") Exposure Draft (ED), *Proposed Accounting Standards on* Financial Instruments-Overall (Subtopic 825-10) – *Recognition and Measurement of Financial Assets and Financial Liabilities*.

Travelers is a leading provider of property and casualty (P&C) insurance products and services to a wide variety of businesses and organizations as well as to individuals. As a P&C insurer with a $73 billion investment portfolio which supports our liabilities, Travelers is very interested in the proposed changes to U.S. GAAP from both an investor and preparer perspective.

Travelers appreciates the Board's objective to simplify the accounting for financial instruments and is very supportive of the principal of linking the measurement of financial instruments to the way in which an entity expects to benefit from the cash flows embedded in those assets. We are, however, concerned with the concept in the proposed model that places a priority on the investment approach meeting the "solely principal and interest" (SPPI) criteria.

The significant limitations, including the strict limitations on sales contained in the ED on qualifying for the amortized cost category cause conflicts with the principal of linking measurement with how an entity expects to benefit from cash flows and effectively limit a

Company's ability to use amortized cost for portfolio's where the overall business model is to collect cash flows from the investment portfolio. As a result, we believe the proposed model would be prevented from meeting its objectives.

As currently drafted, the SPPI criteria will likely cause some debt instruments to be reported at fair value with changes in fair value reported in net income (FV-NI), even in cases where a company has no intention of selling the instruments. Additionally, common stock investments would be reported at FV-NI in instances where the business model is to derive value through dividends or distributions rather than capital appreciation. This appears to create a conflict between the instrument-focused SPPI criteria and the business model criteria.

In addition to the conceptual concerns that we have with the model, we are also concerned with the complexity introduced into the accounting for financial instruments and have concerns with the unintended consequences of the detailed guidance.

Conceptual Concerns with the Proposed Model

Conceptually, we believe that the business model in a portfolio context (i.e., how an entity uses the assets or liabilities in a portfolio) should be the driver in determining the measurement. We believe that in not doing so, significant complexity is introduced into the model and there will be instances where the measurement approach for particular assets will not align with how an entity derives value from those assets. In addition, limiting the amortized cost category may create instances where a Company is forced to report assets within a portfolio at fair value with changes in other comprehensive income (FV-OCI) when the Company has no intention of selling the asset to realize capital gains or losses.

If we use Travelers as an example, and look at the results of the proposed model on both an instrument basis and portfolio basis, we find that the model will yield a result that is at odds with how the cash flows from the assets will be realized. On an instrument basis, several of the asset types that we hold would fail the SPPI test and be reported at FV-NI even though we intend to derive value from the collection of cash flows and not capital appreciation. On a portfolio basis, Travelers would be precluded from reporting its debt securities at amortized cost due to having an insignificant amount of sales in the portfolio even though our business model is to collect cash flows to support insurance liabilities.

Travelers Portfolio and Business Model

Travelers has a substantial bond portfolio (including short-term securities), a small amount of partnerships, real estate and common stocks, to support policyholder claims reserves. The vast majority of the bond portfolio is comprised of municipal bonds, US Treasury Securities and corporate bonds with a small amount of structured investments (general higher tranches). The majority of the common stocks held are in master limited partnership structures (MLP's) that distribute earnings frequently with the remainder in stocks purchased for their dividend yield.

To pay claims, Travelers primarily uses the cash flows from renewal premiums and to a lesser extent, cash flows from the income from the bond portfolio (interest and maturities), and other asset types. Although there is the potential to have to liquidate a portion of the portfolio due to the remote likelihood of either a significant catastrophic event or series of events, Travelers has not had to sell assets from its portfolio to satisfy claims in the past. Additionally, due to the inherent uncertainty as to the timing and amount of claims, Travelers does not attempt to perform asset/liability matching but instead monitors the duration of the investment portfolio relative to the approximate duration of the liabilities and therefore does not need to sell assets to match liabilities. In additoin, there is a disincentive to sell investments since the investments have to be replaced (at current lower yields) and would incur transaction costs. These portfolio dynamics result in a turnover ratio that is not significant (trends well below 10%) and is not a metric utilized by management or reported to investors.

The overall investment model is to maximize net investment income to support the Company's insurance liabilities. Realizing capital appreciation is not a goal of the portfolio and not a metric considered by most P&C investment analysts.

Result of the Proposed Model on Certain Individual Securities

As a result of the proposed SPPI criteria, insurers having an investment strategy similar to Travelers would have to report all of their common stock investments and certain structured securities at FV-NI. When considering these potential changes in measurement, it strikes us that the new reporting category for these investments does not align with the overall portfolio objective and how the cash flows embedded in these instruments are realized. Our common stock portfolio has a large amount of MLP's which distribute income on an ongoing basis and were purchased for this income stream and not capital appreciation. Additionally, the remainder of our common stock portfolio was generally purchased for the dividend yield. We are sympathetic to the view that equity securities should not be afforded the amortized cost categorization, but we believe a FV-OCI categorization would be more representative of how value is derived for investment strategies such as these.

We are also struggling with the rationale of reporting a large portion of beneficial interests at FV-NI when the objective of those assets is to realize value from the cash flows rather than through sales. We don't find the priority created in the structure any different conceptually than what can occur in a corporate structure (e.g., investing in subordinated debt). We understand that there are some tranches that may exhibit equity-like characteristics (i.e., where the return on the tranche can be impacted both positively and negatively by the actual cash flows within the structure) but believe the solution should be to define equity (residual characteristics) and require those tranches with equity characteristics (residual in nature) to be reported at FV-OCI or FV-NI.

Impact of the Model on Travelers Portfolio

In the past five years, Travelers has reported volatility in stockholders equity due to changes in unrealized gains and losses of approximately $6.5 billion (pre-tax) from losses to gains, with

the current amount of unrealized gain of slightly over $4 billion (pre-tax). While we believe that this might be an interesting number to some since it is the result of the quality of the portfolio, it does not help an investor understand future cash flows since the assets will not be sold (realized gains) except under severe conditions, and over time this $4 billion number will be reduced to zero as the bonds mature. In the future, the unrealized gains could be expected to become unrealized losses when interest rates migrate back to historical levels. Once again this may be interesting information, but the outcome is that significant unrealized losses will never be realized. Additionally, since some of the assets will be reported at FV-NI, there would be volatility in income that will recycle over time.

While this may be useful information in a liquidation scenario, we don't believe the information is relevant for a going concern.

Complexity

In moving away from using the business model as the basis for categorizing debt securities, we believe that significant complexity would be added as financial statement preparers would now need to analyze many more debt securities than under the current guidance to ensure that all purchases as well as current holdings meet the SPPI criteria. For Travelers, assuming that no documentation is necessary for U.S. Treasuries and municipal general obligation bonds, this could still be a large number of securities that would need to be analyzed and documented on a security-by-security basis at adoption of the proposed standard for a fairly "plain vanilla" portfolio, just to make sure that there are not any features embedded in the securities that would cause the instruments to fail the SPPI test. Additionally, purchases during a quarter would have to be analyzed which, depending on the level of purchases near the end of a quarter, may make it difficult for preparers to timely complete the analysis in order to meet the filing requirements of the Securities and Exchange Commission. The added complexity does not appear to be an improvement over the current guidance for financial instruments which allows preparers to align the measurement of the instruments with how cash flows will be realized.

Other Technical Concerns

We also have a few technical concerns with the ED. The first is the new language added to ASC 320 to distinguish when an investment accounted for using the equity method would be considered held for sale. As drafted, the language could be interpreted to include many partnership investments having stated termination clauses, since investors would have an exit (wind-down) strategy and the time of exit may be known as it is usually included in the terms of the partnership. Although we don't believe that this is the intent of the language, we suggest clarifying that the language applies to the investor's intentions and not the investee. The second concern is the with the term "beneficial interest". In roundtable discussions and other information forums, some participants have indicated that municipal special revenue bonds may be considered beneficial interests (as the underlying cash flows are not principal and interest) and would be reported at FV-NI. We do not believe that this is the intent of the ED; however, it would be helpful to all parties if there is a common understanding of what is meant by beneficial interests. Finally, the definition of "principal" does not appear to take into

account purchases of credit impaired securities or securities with substantial premiums or deep discounts (other than for liquidity) and would result in the investments failing the SPPI criteria. We do not believe that this is the intent of the guidance and request that the definition of principal address premium and discounts and purchased credit impaired investments.

Summary

We agree with the overall objective of the ED; however, we believe that the rules contained in the ED would prevent the objective from being met in many instances. We suggest that the Board place more reliance on the business model of the reporting entity as this should align with the future cash flows embedded in the investments and would make the guidance more practical to implement. With that being said, we are sympathetic to the view that reporting equity securities (including certain tranches in securitizations) at cost would not be representative of an entity's strategy to realize cash flows and suggest that such instruments be categorized as FV-NI or FV-OCI based on the entity's plans for deriving value. We are not concerned with the additional guidance that would be needed to address the various types of investments since there are different characteristics that warrant different accounting as evidenced by the scope exceptions in the ED. The focus should be on how cash flows from the various instruments will be realized by the reporting entity.

We thank you for the opportunity to comment on the ED and would be pleased to discuss our views with the Board in any forum the Board may hold. If you have any questions or would like to discuss our comments, please feel free to call me at (860) 277-0537.

Regards,

D. Keith Bell

Questions

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?
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?

The scope appears reasonable from a practical perspective; however it would seem that if the principle is appropriate and the detailed guidance follows the principal that there would be less of a need for scope exceptions.

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?

The business model concept is appropriate, but the cash flow characteristics criteria can result in measurements that do not align with the way the entity expects to realize the cash flows embedded in the assets.

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?

We find the contractual cash flow characteristics assessment to be more of a set of rules which conflict with the overall principle of the proposed ASU. We would recommend using a business model approach which allows debt instruments to be measured at amortized cost, FV-OCI and FV-NI; and equity investments to be measured at FV-OCI and FV-NI. We appreciate the concerns with the residual tranches of structured securities, but believe that this can be addressed by defining that tranches that are exposed to both risk and rewards from the structure (as opposed to changes in interest rates) are equity regardless of how they are defined in the prospectus.

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 are confused as to how this definition would be applied to credit impaired securities or securities where there is significant premium or discount. It would appear in a strict reading of the proposal that these instruments would fail the cash flow characteristics test, which doesn't seem appropriate and at odds with the concepts in the Credit Loss Exposure Draft.

Question 6: Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?
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?
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?
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 believe that this guidance is not necessary since the results of applying the criteria to some investments will cause a categorization that does not align with how the entity will benefit from the embedded cash flows in the investment. We also believe that the criteria, especially the look-through provisions add significant complexity without adding discernible benefits. A business model approach would be preferable, but we do acknowledge that some guidance is necessary to define that tranches with residual characteristics in structured securities should be accounted for as equity.

Question 10: Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?
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 limitation on sales activity to meet the amortized cost category is very narrow. Entities should be allowed to have an insignificant amount of sales as long as the sales are aligned with the objective of receiving cash flows and not for capital appreciation purposes. For instance, in a P&C insurance context, when an asset is sold it generally will need to be replaced to help support the insurance liabilities. If sales are made to improve the future cash flow prospects or for credit reasons (individual or sector), it does not change the overall portfolio objective. It is important to note in the analysis of P&C insurance companies that realized gains and losses are not a significant source of income.

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?

No, the business model should be based on how the company manages its assets at a portfolio level. Insignificant activity should not taint the business model assessment.

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?

No comment.

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

Yes, the initial measurement and subsequent measurement should be aligned for the types of instruments in scope.

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?

No comment.

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

We agree that most financial liabilities should be measured at amortized cost.

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?

No comment.

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?

Yes, we agree that the realization of cash flows is an important concept for gain recognition.

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 believe that using the equity method of accounting would provide more useful information.

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?

No comment.

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?

No comment.

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?

No comment.

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?

As long as the information is in the notes, it is not necessary to be on the face of the statement of financial position. In order to be decision-useful the accompanying credit quality information is necessary and that information is in the notes.

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?

No comment.

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 don't believe that an entity should benefit from a deterioration of their own credit unless it can be realized; therefore, this is a more reasonable approach if the fair value option is allowed. However, we believe that the fair value option on liabilities should only be allowed in instances where the fair value can be realized and it is the intent of the entity to realize it by settling the obligation at fair value.

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?

Conceptually we believe that the proposed guidance is logical; however, we are concerned about cases where the foreign denominated assets are supporting foreign liabilities (e.g., insurance liabilities) that will be translated to U.S. dollars in consolidation. This will cause an accounting mismatch.

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?

No comment.

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

No comment.

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

No comment.

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, it may lead to investor confusion if part of a standard is adopted and some reporting entities early adopt and others don't.

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

No comment.

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

It is difficult to estimate without understanding the level of documentation necessary; however, it is probably reasonable to estimate that it would take up to a year to analyze all investments and put processes (including SOX controls) in place to analyze new purchases.

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

The transition provisions appear to be reasonable.

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?

All though we do not believe it is the intent of the proposed guidance, as drafted, the guidance could be interpreted to indicate that all partnerships with a fixed time frame would be considered as held for sale. We recommend that wording be added to clarify that the normal partnership wind down language does not cause the partnership investment to qualify as held for sale.

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 agree with the approach.

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?

No comment.

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?

No comment.