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Technical Director
File Reference No. 2012-260
Financial Accounting Standards Board
P.O. Box 5116
401 Merritt 7
Norwalk, CT 06856-5116

Via e-mail @ director@fasb.org

Re: Proposed Accounting Standards Update: Financial Instruments – Credit Losses (Subtopic 825-15)

Dear Technical Director:

The Hartford Financial Services Group Inc. ("The Hartford" or "we") appreciates the opportunity to comment on the Financial Accounting Standards Board's Proposed Accounting Standards Update ("ASU") issued December 20, 2012 concerning *Financial Instruments - Credit Losses* (*Subtopic 825-15*). The Hartford is an insurance and financial services company that provides investment products and life and property and casualty insurance to both individual and business customers in the United States. The Hartford holds a \$115 billion investment portfolio that includes debt securities, equity securities, commercial mortgage loans and limited partnership (equity method) investments and will be impacted by the final guidance resulting from this proposed ASU.

The Hartford supports the goal of providing financial statement users with more decision-useful information about expected credit losses on financial instruments. We believe that this goal can be achieved by replacing the current incurred credit loss impairment model with a model that recognizes expected credit losses and considers a broader range of reasonable and supportable information to develop credit loss estimates for debt instruments carried at amortized cost such as loans. However, we believe the model is an unwarranted change for debt instruments carried at fair value. We also believe that certain adjustments to the model as it affects interest income recognition would be needed for debt instruments.

With respect to debt instruments carried at fair value with changes in fair value recorded in other comprehensive income, we view the current impairment model for debt securities as being very effective. The current model was modified during the financial crisis in 2009 and has worked well for debt securities recorded at fair value. It replaced the probable loss threshold with the use of expected cash flows to calculate the amount of expected credit losses. Therefore, we recommend that the ASU exclude debt securities carried at fair value from the scope.

The Hartford offers the following recommendations, which are further discussed under the relevant questions from the proposed ASU in the attached appendix.

- ❖ Exclude debt instruments carried at fair value from the scope of the ASU because these are measured at fair value which includes the market's estimate of credit losses. With respect to debt instruments classified fair value with changes in fair value reported in other comprehensive income (FV-OCI), existing guidance appropriately separates and recognizes credit losses in net income. Any additional losses recognized through net income would be immediately offset by an unrealized gain in other comprehensive income to arrive back at the fair value that is the carrying value. [Refer to questions 1, 11 & 14]
- ❖ If debt instruments carried at fair value remain within the scope of the ASU, revise the practical expedient for financial assets that are debt instruments classified at FV-OCI to allow no credit impairment allowance for investments with insignificant expected credit losses (e.g., highly rated debt securities). Remove the second condition that also requires the fair value to be in excess of the amortized cost because that second condition allows for no credit impairment allowance only when there is also no unrealized loss due interest rates. [Refer to questions 11 & 14]
- ❖ Eliminate the notion of and special accounting for purchased credit impaired assets. Among other concerns, it is impractical to require companies to research and analyze an asset's credit quality at acquisition against its credit quality at original issuance. [Refer to questions 12, 13 & 15]
- ❖ Eliminate the requirement to use the cost-recovery method or cash-basis income method in cases where it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. Rather, entities should follow one model for all interest-bearing financial assets similar to today's interest income recognition for debt securities. Today's model appropriately maintains an amortized cost and expected yield that reflects the economics at the time of purchase adjusted for changes due to prepayments, instrument-specific credit losses, debt modifications and other factors. In particular, we cannot conceive how nonaccrual accounting would be applied to structured debt investments. [Refer to questions 12, 15 & 19]
- ❖ Establish and maintain the credit loss allowance as a general allowance that would not affect the amortized cost of individual debt instruments. Continue to adjust the amortized cost for instrument-specific credit losses under the current U.S. GAAP impairment model to reflect the economic yield to the entity. Do not try to specify ways that the allowance should be adjusted for

- various changes in amortized cost due to changes in expected cash flows or for assets that have experienced significant credit deterioration since originally issued. [Refer to questions 12, 13, 15 & 19]
- ❖ Eliminate the notion of and special accounting for troubled debt restructurings and utilize the current test for a significant debt modification of a debt security. As under current U.S. GAAP, companies should assess whether a debt modification changes the present value by more than 10% as measured using the effective interest rate in order to determine whether to account as an exchange of significantly different instruments (at fair value) or through an adjustment to the prospective yield (at carryover basis). [Refer to questions 12 & 16]
- ❖ Explicitly state that entities would not have to recognize impairments down to fair value if there is an intention to sell a financial asset in an unrealized loss position and make this requirement applicable to all financial assets whether they are classified at amortized cost or FV-OCI (not applicable for FV-NI).

 [Refer to question 18 of our comment letter on the proposed ASU: Financial Instruments − Overall that addresses recognition and measurement]

Thank you for the opportunity to provide input on the proposal. Please contact me at 860-547-4848 or scott.lewis@thehartford.com if you would like to discuss our responses.

Sincerely,

Scott R. Lewis

Attachment - Appendix

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APPENDIX QUESTIONS FOR RESPONDENTS

Scope

Questions 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?

The Hartford does not agree with the scope of the proposed ASU.

We recommend the scope exclude debt instruments carried at fair value because these are measured at fair value which includes the market's estimate of credit loss and existing guidance appropriately separates and recognizes credit losses in net income. Any additional losses recognized through net income would be immediately offset by an unrealized gain in other comprehensive income to arrive back at the fair value that is the carrying value. We view the current impairment model for debt securities which was modified in 2009 to address concerns surfaced during the financial crisis, as being very effective. It replaced the probable loss threshold with the use of expected cash flows to calculate the amount of expected credit losses. Therefore, we recommend that the ASU exclude debt securities carried at fair value from the scope.

We also recommend that policy loans extended by insurance companies against the cash value of life insurance policies be excluded from the scope because they have no history nor possibility of losses. The loan is less than the insurance liability and would always be recoverable as a reduction to any payout under the insurance liability. Alternatively, policy loans could be accommodated by providing an exception to the requirement that an entity always assume some expected credit loss (refer to Question 11).

Recognition and Measurement

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?

We foresee significant operability and auditing concerns associated with the historical loss experience and supportable forecast information required to base estimates of expected losses. The Hartford does not have readily available historical credit loss experience for its investments identified over past economic cycles, most notably for its debt securities and commercial mortgage loans. Therefore we would have to perform historical studies to develop loss statistics and views about the past to predict the future. We would need to make decisions about how to group the assets, whether to measure

credit losses specific to our own loss at sale or make estimates of the investment's ultimate loss, whether to distinguish losses at sale from losses at settlement and how to characterize historical periods as to their point in economic and underwriting cycles. Making this additionally challenging is that our historical credit loss information is measured under existing accounting rules and we would have to adjust that historical experience to reflect the ASU's accounting which includes special accounting for purchased credit impaired assets, non-accrual income and cost recovery that can each affect the measurement of recovery. We would likely face additional challenges for new investment types that lack experience. We believe the effort and judgments would make auditing the information equally challenging and result in a large cost to preparers.

While some market information on historical credit loss experience is available, it may not be adequate to reflect the credit risk of our own portfolio of investments. Reasonably available market information would likely include historical loss statistics by type of security, credit rating and tenor from rating agencies for debt securities and historical loss statistics by collateral type, geographic location, loan-to-value ratio, debt service coverage ratio and tenor for commercial mortgage loans from credit analysis firms. However, that experience would not reflect our own portfolio of investments nor our investment management.

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?

As stated in Question 9, The Hartford does not have readily available historical credit loss experience for its investments identified over past economic cycles, most notably for its debt securities and commercial mortgage loans, and developing that information would come at a large cost. While some market information is available from rating agencies and credit analysis firms, that experience would not reflect our own portfolio of investments nor our investment management. We also have concerns that reasonably available market information could also come under the scrutiny from auditors and the SEC as to whether a user has performed sufficient investigation and analysis to rely on the information by rating agencies and credit analysis firms, similar to the way the use of pricing services is scrutinized with respect to fair values.

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 understand the requirement is intended to estimate <u>some</u> expected credit loss with few exceptions and believe that requirement is appropriate for a credit allowance particularly on a pool of similar assets. However, we have two related comments.

As discussed in Question 1, we recommend policy loans extended by insurance companies against the cash value of life insurance policies be excluded from the scope because they have no history nor possibility of losses. The loan is less than the insurance liability and would always be recoverable as a reduction to any payout under the insurance liability. Alternatively policy loans could be accommodated by providing an exception to the requirement that an entity always assume some expected credit loss.

As previously stated, we recommend debt instruments carried at fair value be excluded from the scope of the ASU because these are measured at fair value which includes the market's estimate of credit loss and existing guidance appropriately separates and recognizes credit loss in net income. However, if debt instruments carried at fair value remain in scope, we recommend that the practical expedient for financial assets that are debt instruments classified at FV-OCI be revised. The guidance should provide that a credit impairment allowance is not necessary for investments with insignificant expected credit losses (e.g., highly rated debt securities) regardless of whether or not the investment is in an unrealized loss position due to changes in interest rates.

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 agree that the allowance for credit losses should reflect the time value of money. We believe the objective of the amortized cost framework is to reflect a rate of return in the income statement by appropriately maintaining an amortized cost and yield that reflects the economics at the time of purchase adjusted for changes due to prepayments, instrument-specific credit losses, debt modifications and other factors. As it is under current U.S. GAAP accounting for debt securities, any instrument-specific expected credit loss would continue to be an impairment of the investment that adjusts the amortized cost. We believe that any credit allowance for additional expected credit losses, as required under the provisions of this ASU, should be a general allowance that would not affect the amortized cost of individual debt instruments. To accomplish this, we believe that the ASU should adopt the current instrument-specific impairment guidance for all debt investments (loans as well as debt securities) and eliminate the special accounting for purchased credit impaired assets, troubled debt restructurings and nonaccrual income recognition.

We also note that reinsurance receivables may need to be reconsidered in the future if a new insurance contracts standard changes the measurement of this financial asset through discounting. We currently reserve for credit losses based on a credit analysis of the reinsurers and believe that would continue unchanged under the ASU. In this way the time value of money is appropriately incorporated under the ASU in that the expected credit loss reflects the effective rate of the reinsurance which is zero for undiscounted property and casualty contracts today. Reinsurance receivables should be discounted at the effective rate of the reinsurance liabilities, and the credit allowance should reflect the effective rate of the reinsurance asset which may change under the soon-to-be-exposed insurance contracts standard.

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?

Purchased credit impaired ("PCI") assets are defined as those that have experienced significant credit deterioration since being issued. We believe there would be significant operability and auditing concerns with identifying PCI assets because entities would be required to research and analyze an asset's credit quality at acquisition against its credit quality at original issuance, as well as determine what is significant. This is highly impractical.

We recommend the ASU eliminate the notion of and special accounting for PCI assets and instead determine one model for amortized cost that can work for all debt instruments. The objective of the amortized cost framework should be to reflect a rate of return in the income statement by appropriately maintaining an amortized cost and yield that reflects the economics at the time of purchase, including expected cash flows, adjusted for changes due to prepayments, instrument-specific credit losses, debt modifications and other factors. Any additional credit allowance should be a general allowance that would not affect the amortized cost of individual debt instruments.

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 foresee any operability or auditing concerns with respect to the criteria for applying the practical expedient. However, we would not expect to use the practical expedient as described because interest rate movements drive much of the reason for whether fair value is above or below amortized cost. As discussed in Questions 1 and 11,

we recommend debt instruments classified at FV-OCI be excluded from the scope of the ASU.

If debt instruments classified at FV-OCI remain in the scope of the ASU, we recommend the guidance should provide that a credit impairment allowance is not necessary for investments with insignificant expected credit losses (e.g., highly rated debt securities) regardless of whether or not the investment is in an unrealized loss position due to changes in interest rates. If expected credit losses are insignificant than the ASU should not require an allowance be recognized when interest rates give rise to an unrealized loss. The credit allowance should not be dependent on the market level of interest rates.

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?

The Hartford believes the nonaccrual income and cost recovery recognition rules will significantly distort interest income yields, create income volatility, and confuse investors, as well as create significant operability and auditing concerns.

We are very concerned about the potential impacts on interest income from this proposal. We believe the proposal will decrease reported interest income such that it does not reflect expected yields. As an insurance entity, interest income is a significant measure of our business and should not be distorted based upon income and cost recovery recognition requirements that do not reflect expected yields.

Regarding operability and auditing, we cannot conceive how nonaccrual accounting would be applied to structured debt investments (even simple prepayable residential mortgage-backed securities) which have changing effective rates due to the variable amounts and timing of cash flows. Even regarding simple bullet bonds (periodic interest and all principal at maturity) purchased at a discount related to expected non-collectable amounts, the combination of the PCI and nonaccrual income recognition rules would reflect a cash-basis income (likely zero for some period) and not the expected yield.

We recommend the ASU eliminate the proposed nonaccrual accounting and address interest income recognition for all interest-bearing financial assets in one model similar to today's accounting for debt securities that can appropriately maintain an amortized cost and expected yield that reflects the economics at the time of purchase adjusted for changes due to prepayments, instrument-specific credit losses, debt modifications, and other factors. We believe the amortized cost basis of a financial asset should continue to represent the present value of future benefits and the accretion between the present value and the future value should be recorded as interest income.

An alternative to the proposed nonaccrual guidance for investment income recognition would be to follow established guidance around debt securities in which the amortized cost basis of a debt security accretes to the future value of the best estimate cash flows.

Subsequent changes to cash flows affect the amortization pattern either retrospectively through an adjustment to the amortized cost or prospectively through an adjustment to the expected yield. Many investment accounting systems are able to accrete to a future value based on a series of expected cash flows that may or may not include the full return of the original face value of the loan or security. In the interest of simplicity through one model, we recommend subsequent changes to cash flows always be reflected through a prospective yield adjustment, except for instrument-specific credit losses that would adjust the amortized cost based on the prospective yield immediately before the impairment.

We believe better attention to the amortized cost model and simply overlaying a credit impairment allowance or overlaying any mark to fair value through OCI will result in appropriate measurement of financial assets and appropriate interest income from these assets.

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 that the distinction between types of modifications to debt instruments provides relevant information, nor is the troubled debt restructuring designation warranted. Under current U.S. GAAP, the troubled debt restructuring designation primarily provides a threshold for recognition of a loan impairment upon an adverse change in the terms due to a debtor's financial difficulties and does not apply to debt securities. (However, in practice any loan impairment is recognized well before the actual restructuring.) We recommend the ASU eliminate the notion of and special accounting for troubled debt restructurings. Instead, the accounting should follow the current test for a significant debt modification of a debt security (a modification that changes the present value by more than 10% as measured using the effective interest rate) to determine whether to account for the modification as an exchange of significantly different instruments (at fair value) or as an adjustment to the prospective yield (at carryover basis). This approach would eliminate judgmental analysis by companies and auditors and create consistency among entities for restructurings and exchanges of all types of debt investments.

Disclosures

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?

The disclosure requirements are voluminous and we need further time to evaluate their operability. We will need time to research and develop information to estimate and be able to describe how expected losses are developed. With regard to auditing concerns, as stated in Question 9, estimated losses will be based on a variety of information and judgments and we expect it would require substantial effort and cost, including the effort to develop the information in a way that it can be consistently maintained, controlled and audited.

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?

The implementation guidance is not sufficient in that it focuses on loans and does not address structured debt investments nor debt securities in general. As communicated throughout our comment letter we believe any instrument-specific expected credit loss should continue to be an impairment of the investment that adjusts the amortized cost and that any credit allowance for expected credit losses on the portfolio, as required under the provisions of this ASU, should be a general allowance that would not affect the amortized cost of individual debt instruments.

Transition and Effective Date

Questions for All Respondents

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

The Hartford has no objection to the transition provisions which would report the cumulative effect of adoption in retained earnings as of the beginning of the period implemented.

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

The Hartford has no opinion on this matter.

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?

The Hartford has no opinion on this matter.

Questions for Preparers and Auditors

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

We do not believe that the transition provision is operable for debt securities, particularly structured debt securities. As a result of the recent credit crisis, The Hartford has recognized other-than-temporary impairments for many structured debt securities

resulting from a reduction in expected cash flows. Many of these securities remain on the books of The Hartford. The book values and yields of these securities must be adjusted retrospectively as part of the transition process. Impairments must be reversed; investments must be assessed for when to cease accrual and apply cash basis income recognition and cost recovery accounting; and cash payments must be reallocated in accordance with the new income recognition criteria. The Hartford does not have the systems needed to calculate and process these reversals and adjustments. If the Board does not intend that all of these adjustments be made as a part of the transition, additional guidance must be provided. However, if the existing impairment requirements and income recognition in current U.S. GAAP is not changed by this ASU, then transition for debt securities will be relatively straight-forward.

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?

We estimate The Hartford would need 30-36 months to implement the proposed guidance.