



October 25, 2013

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**File Reference No. 2013-290: *Insurance Contracts (Topic 834)***

We appreciate the opportunity to comment on the FASB's (the "Board") exposure draft, *Proposed Accounting Standards Update<sup>1</sup>, Insurance Contracts (Topic 834)* ("the exposure draft" or "the proposal") developed jointly by the Board and the International Accounting Standards Board (the "IASB" or collectively, the "Boards"). Regions Financial Corporation ("Regions"), with nearly \$120 billion in assets, is one of the nation's largest full-service providers of consumer and commercial banking, wealth management, mortgage and insurance product services. We serve customers in 16 states across the South, Midwest and Texas, and through our subsidiary, Regions Bank, operate approximately 1,700 banking offices and 2,000 ATMs.

In order to fully consider the exposure draft and assess how the proposed changes would impact our company, we discussed the exposure draft with business leadership responsible for the management of in scope contracts. We also participated in various conference calls discussing the proposal with public accounting firms, as well as the American Bankers Association ("ABA"), and the FASB Staff.

***Summary Conclusion / Recommendation***

Overall, we are in support of the efforts of the Boards to improve accounting standards and we conceptually agree that accounting for insurance contracts should be governed by characteristics of the underlying contract, as opposed to characteristics of the issuing company. However, we do not agree with the proposal's inclusion of certain common banking products in the scope of insurance, because we believe these products do not contain insurance risk, as defined. Inclusion of these products in the scope of insurance adds unnecessary complexity (both financial and operational) and volatility while failing to be representationally faithful to the more appropriate risk, financial risk. Considering this, we contend that the proposal does not represent an improvement over existing Generally Accepted Accounting Principles ("GAAP") and, as a result, should not be adopted as exposed.

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<sup>1</sup> Hereafter, "ASU"

At the impasse of our differing views is the inclusion of credit risk within the definition of insurance risk. The proposal's definition of insurance risk is "...fortuitous<sup>2</sup>; the possibility of adverse events occurring is outside the control of the insured". Credit risk-related products do contain a degree of uncertainty, so they may technically contain insurance risk, as defined. However, the degree of cash flow uncertainty introduced by credit risk is markedly different than the fortuitousness of a car accident, an injury, a fire, an illness or an untimely death. As opposed to these common examples of insurance risk, the degree of uncertainty associated with credit risk is generally foretold by cascading antecedental economic events, and therefore, should generally not be considered to occur by chance or luck.

Moreover, the highly anticipatory nature of credit risk affords financial institutions the ability to actively manage exposure to credit risk throughout the contractual life. In many cases, financial institutions are able to avoid significant loss simply by selling the instrument containing unwanted credit risk<sup>3</sup>. In other cases, the financial institution is able to manage credit risk by adjusting payment structures or requiring additional collateral. As recognized by the proposal<sup>4</sup>, insurance risks expose the institution to significant loss throughout the contractual life of the contract. Thus, based on ASU 834-10-15-5(k)(1), it appears appropriate to exclude credit risk from insurance risk.

Further complications arise when comparing and contrasting the proposal's definition of credit risk with explicit/implicit definitions contained within other proposals and within the proposal itself. The proposal defines financial risk as, "The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, **credit rating or credit index**, or other variable" (**Emphasis Added**). By defining changes in credit rating/credit indices as financial risk, the proposal attempts to scope-out credit risk measurement while scoping-in credit risk itself. This is confusing and seems illogical.

In addition, other proposals present the idea of credit risk in such a way that it appears inseverable from financial risk. For example, the Classification and Measurement Exposure Draft<sup>5</sup> cites credit risk as a seminal characteristic in the measurement and classification of non-insurance financial instruments<sup>6</sup>. It is unclear to us how credit risk represents compensation for

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<sup>2</sup> Merriam-Webster defines "fortuitous" as "occurring by chance or happening by luck".

<sup>3</sup> Of course, if the financial instrument is indeed sold, the holder would often realize losses from declines in fair value – risks that are specifically noted as "financial risks".

<sup>4</sup> ASU 834-10-15-5 and ASU 834-10-15-5 (k)(1) – "An entity shall apply the guidance in this Subtopic to all contracts that meet the definition of an insurance contract, except for all of the following ... A guarantee that does not expose the counterparty to risk throughout the term of the guarantee, that is, from inception of the guarantee contract and throughout its term ..."

<sup>5</sup> Formally entitled "**Proposed Accounting Standards Update, Financial Instruments—Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities**".

<sup>6</sup> ASU 825-10-25-17 A financial asset satisfies the contractual cash flow characteristics criterion if the contractual terms of the financial asset give rise on specified dates to cash flows that are **solely payments of principal and interest** on the principal amount outstanding.

**825-10-25-18** For purposes of this Subtopic, *principal* is the amount transferred by the holder at initial recognition. *Interest* is consideration for the time value of money and for the **credit risk** associated with the principal amount outstanding during a particular period of time, which may include a premium for liquidity risk. (**Emphasis Added**)

non-insurance financial instruments within the Classification and Measurement Exposure Draft, while, at the same time, it represents compensation for insurance risk within the proposal.

Considering all the aforementioned, we believe inclusion of credit risk within the definition of insurance risk will result in confusion among preparers and users of the financial statements. As a result, Regions recommends the proposal be amended to include credit risk wholly within the definition of financial risk. As illustrated above, Regions does not believe banking products based predominately on credit risk fit into the Board's *overall* definition of insurance risk (i.e. – they are not fortuitous). Thus, excluding the vast majority of banking products from the scope of the exposure draft (by excluding credit risk) would not only avoid confusion, but also maintain the Board's overall definition of insurance risk.

We note that financial guarantee contracts are excluded from the scope of the IASB exposure draft on insurance contracts, unless the issuer has previously asserted explicitly that it regards those contracts as insurance contracts and has used accounting applicable to insurance contracts. While we believe that banking products should not be included within the scope of the exposure draft because credit risk is a financial (and not insurance) risk, the IASB's explicit scope exception is acceptable. Our detailed conceptual reasons are discussed below.

In addition to recommending that credit risk be wholly included within the definition of financial risk, we also recommend that the Board provide the fair value option for in scope contracts. Not only is the concept of fair value widely understood by the market, but also using fair value measurement instead of the proposed Building Block Approach<sup>7</sup> or Premium Allocation Approach<sup>8</sup> significantly reduces the operational burden the proposal places on preparers.

The comments included above are a summary of items discussed with further detail in the appendix attached herewith. Again, we appreciate the opportunity to comment on this exposure draft and we thank you for considering our views. If you have any questions about our comments or wish to discuss this matter further, please contact me at (205) 326-4972.

Sincerely,



Brad Kimbrough  
Executive Vice President, Controller and  
Chief Accounting Officer

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<sup>7</sup> ASU 834-10-30-1 through 834-10-30-16

<sup>8</sup> ASU 834-10-30-17 through 834-10-30-25

## *Appendix - Detailed Perspectives, Areas of Concern and Rationale*

Based on our review, we have numerous specific areas of concern as follows:

*Inclusion of Credit Risk within Insurance Risk* - The inclusion on credit risk as insurance risk results in many traditional banking products being captured in the scope of the exposure draft. We believe these traditional banking products are significantly different than other insurance products; to include them within the scope of the proposal is not representationally faithful, and it introduces unnecessary complexity, confusion and earnings volatility.

*Standby Letter of Credit (“SBLC”)* - Regions issues off-balance sheet financial instruments in connection with lending activities. The credit risk associated with these instruments is essentially the same as that involved in extending loans to customers and is subject to Regions’ normal credit approval policies and procedures. Regions measures inherent risk associated with these instruments by recording a reserve for unfunded commitments based on an assessment of the likelihood that the guarantee will be funded and the creditworthiness of the customer or counterparty. Collateral is obtained based on management’s assessment of the creditworthiness of the customer. SBLC’s are also issued to customers, which commit Regions to make payments on behalf of customers if certain specified future events occur. Regions has recourse against the customer for any amount required to be paid to a third party under a SBLC.

Regions believes this structure is significantly different than standard insurance products. First, in a traditional insurance contract, when an insured event occurs a loss is recognized, the claim is paid and the insurer has no continuing involvement. In contrast, when a SBLC is funded, an asset is recorded<sup>9</sup> representing a collateralized loan to the customer, upon which the bank earns interest. Additionally, SBLC’s are often fully collateralized, with no expected loss to be realized.

SBLC’s are better categorized as loan commitments between a bank and its customer, not as insurance contracts. While the table on page 85-86 notes instances in which a SBLC may be considered outside the definition of an insurance contract, the distinction between what is in scope and out of scope is very confusing.

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<sup>9</sup> A contingent loss is currently provided for under ASC 450 prior to funding the SBLC

### Loan sales

Often, financial institutions sell loans with a recourse or indemnification provision in the sales agreement. If loans experience a default or other adverse event, the financial institution is then obligated to either buy back the loan or provide some other form of compensation. This transaction is not specifically included within the tables on pages 76 – 88, so differing conclusions have been drawn on whether this transaction constitutes an insurance contract. We note that during a FASB Staff discussion hosted by the ABA on August 14<sup>th</sup>, the Staff stated that this guarantee would be excluded because it would be considered a guarantee of one's own performance. However, PricewaterhouseCoopers ("PwC") issued a Dataline stating:

The implementation guidance includes some banking examples that may be unexpected. For example, representations and warranties that certain loans transferred into a securitization structure conform to specified guidelines **would be considered insurance**. Currently, many characterize these as guaranteeing the bank's own underwriting performance.<sup>10</sup> **(Emphasis Added)**

Although PwC is specifically speaking to transfers of securitized beneficial interests, inference can be drawn to other loan sales where the purchaser is not a securitized loan pool. Given that this has significant implications to our business, we strongly encourage the Board to include some clarifying language. We believe the current contingency (ASC 450) and guarantee guidance (ASC 460) sufficiently reflect the economics of these transactions. As a result, we recommend that the FASB allow these transactions to be accounted for using current guidance.

### Performance guarantees, Indemnities

These types of guarantees are generally accounted for under ASC 450, Contingencies, and ASC 460, Guarantees, and we are not aware of pervasive accounting and reporting issues or requests for changes to the accounting and reporting associated with these transactions. We do not believe the costs of applying the complex provisions of the proposal by financial statement preparers will justify the benefits to be obtained by financial statement users. If the Board is intent on including indemnifications within the scope of the exposure draft, we urge the Board to include some clarifying guidance or practical expediciencies. Indemnification language is included in virtually all modern contracts, so the operational cost of analyzing and calculating "the present value of the unbiased, probability-weighted estimate of the future cash flows that will arise as an entity fulfills the insurance contract"<sup>11</sup> would be massive.

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<sup>10</sup> Doran, Donald; Christopher Irwin, Mary Saslow, Chris Filiaggi. **Dataline:** "FASB and IASB exposure draft issued in June 2013 would significantly change accounting for insurance contracts". [www.cfodirect.pwc.com](http://www.cfodirect.pwc.com). No 2013-19. August 14, 2013. Page 4.

<sup>11</sup> ASU Glossary - **Fulfillment Cash Flows**, page 28