

April 1, 2011

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Chairman
Financial Accounting Standards Board
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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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Re: FASB File Reference No. 2011-150, “Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Supplementary Document on Impairment” and IASB “Financial Instruments: Impairment, Supplement to ED/2009/12 on Financial Instruments: Amortised Cost and Impairment”

Dear Chairman Seidman and Sir David:

The Financial Instruments Reporting and Convergence Alliance (“FIRCA”) is a coalition of a number of trade organizations – American Council of Life Insurers, Commercial Real Estate Finance Council, Council of Federal Home Loan Banks, Group of North American Insurance Enterprises, Mortgage Bankers Association, Property Casualty Insurance Association of America, The Real Estate Roundtable and The U.S. Chamber of Commerce – representing all sectors of the economy and areas of the financial services arena. FIRCA recognizes that accurate and transparent financial reporting is a cornerstone of our capital markets in the United States and globally. FIRCA appreciates the opportunity to comment on the Financial Accounting Standards Board (“FASB”) and International Accounting Standards Board (“IASB”) Supplementary Document on Impairment (“the Proposal”).

FIRCA supports the overarching premise that accounting and reporting for financial instruments should reflect both a reporting entity’s strategy for the instruments and its business model. The financial statements should help explain the business and its operations on a going concern basis. In order to do so, the

classification, measurement, and disclosures for financial instruments need to reflect the entity's purpose for holding these assets and liabilities and its strategy for managing them.

Core Principles for Impairments

FIRCA supports the general principle that recognition of an impairment loss in the income statement for financial assets not accounted for at fair value with changes in fair value recognized in net income each reporting period should be based on an expectation of a future loss in cash flows attributable to either a credit loss or an anticipated sale of the asset for a loss. FIRCA also supports the following considerations related to impairments:

- The income statement should reflect a reduction in expected future cash flows from cash flows anticipated at the acquisition date or latest impairment adjustment, if applicable.
- Expected losses should be recognized over the life of the financial assets, not at origination.
- Impairment recognition can be triggered by either an expected sale of an impaired financial instrument or a credit loss resulting from an estimated reduction in expected future cash flows.
- Equity securities do not have an expected cash flow stream. Impairment for equities occurs when it is expected the cost basis will not be recovered in a reasonable time period.
- Recoveries of previous impairments should be allowed, not to exceed cumulative previous impairments recognized.
- Entities that hold securities for the purpose of trading should record all changes in fair value through the income statement alleviating the need for impairment guidance.
- Expected cash flows are projected based on all relevant and reliable information available, including historical trends adjusted for current conditions and projected future economic conditions and variables. Use of static assumptions based only upon existing economic and market conditions

would be extremely pro-cyclical and not representative of the cash flows the reporting entity expects to receive.

- A financial instrument can be evaluated on either an individual basis for impairment or by using a pooled method. The objective of both methods continues to be to identify a change in expected cash flows.
- If a financial instrument is evaluated individually for impairment, a pooled method is not required as a second step of the impairment evaluation.

Specific Comments

As previously noted, FIRCA appreciates FASB and IASB soliciting timely feedback on impairment issues using a supplementary document, albeit one explicitly narrow in scope. Even so, it is worthwhile recognizing that commenting on the Proposal is hampered because FASB and IASB have not yet finalized their conclusions on classification and measurement. Conclusions on these matters would provide a frame for considering the Proposal on impairment.

The Proposal puts forth an impairment model for financial assets managed in *open portfolios*. The Proposal provides guidance that would be consistent with FIRCA's core principles for loans, but not necessarily for debt securities or other financial assets including those within separate legal structures. Thus, FASB and IASB should not extend this Proposal to apply a single impairment model to all financial assets or even all financial assets reported at amortized cost, especially those not managed in open portfolios. In accordance with FIRCA's core principles, a reporting entity's business model and risk management strategies are important for considering classification, measurement, and, consequently, impairment issues.

For financial assets managed in open portfolios, the Proposal would require an allocation of such assets into two groups based on the credit characteristics of the assets in accordance with an entity's internal risk management. The Proposal uses the terms "good book" and "bad book" to describe these two groups. As an aside, FIRCA is not aware that these are terms commonly used in practice and questions the wisdom of introducing defined terminology with pejorative connotations into generally accepted accounting principles ("GAAP").

The Proposal specifies that the bad book would consist of those financial assets that the collectability has become so uncertain that the entity's credit risk management

objective changes for that asset or group thereof from receiving the regular payments from the debtor to recovery of all or a portion of the financial assets. Even if entities do not manage credit risk in a way similar to this principle of a good book/bad book, they would still need to differentiate their financial assets into these two groups for the purposes of determining the impairment allowance.

The Proposal does appear to represent an improvement from the prior FASB and IASB exposure drafts related to impairments. Nonetheless, it raises a number of questions, too. For example, open loan portfolios are commonly managed and reported based on their accrual status, which is not recognized per se in the Proposal. Based on guidance in the Proposal it appears that open portfolio loans in nonaccrual status would, depending on circumstances, be included in either the good book or bad book,¹ which represents a source of potential confusion for financial statement users.

For financial assets managed in open portfolios, the Proposal would require recognition of an impairment allowance that is the total of the allowances for the good book and bad book. The good book impairment allowance would be the higher of the time-proportional expected credit losses or all credit losses expected to occur within the foreseeable future. The amount of the bad book impairment allowance would always be equal to the lifetime expected credit losses.

The Proposal states that the foreseeable future is the time period for which specific projections of events and conditions are possible and the amount of credit losses can be reasonably estimated based on those specific projections. While the foreseeable future would be no less than 12 months after an entity's reporting date, more guidance is needed on how much longer than one year it would be. As it is, the Proposal only says that the foreseeable future would be a fairly constant period, not expected to change significantly from period to period for a particular portfolio (although it may differ for different asset classes), and may be the same as or shorter than the remaining average expected life of the portfolio. In addition, reinforcing FIRCA's concern that more guidance is necessary on this issue, there are indications that globally some regulators may view the foreseeable future as a "bright-line" of 12

¹ The Proposal states that actions consistent with recovery of a financial asset (bad book) depend on the type of asset, but would include evaluating or taking actions such as the enforcement of security interests (e.g., foreclosure on real estate or seizing assets under collateral agreements), debt restructuring in order to avoid or resolve non-performance of the asset, exercise of a call option that becomes exercisable depending on breach of debt covenants that relate to credit risk, or attempting to recover cash flows from an uncollateralized financial asset by making contact with the debtor by mail, telephone, or other methods. The Proposal also states that entities often manage such financial assets on an individual basis and separately from the financial assets for which the credit risk management objective is receiving regular payments from the debtor.

months, rather than a minimum. FIRCA does not recommend a “bright-line” definition of foreseeable future.

Finally, the Proposal provides little guidance on computation of time-proportional expected credit losses other than to say that they should be determined on (a) a straight-line approach using either a discounted or undiscounted estimate or (b) an annuity approach. For example, the Proposal does not specify whether cash flows are meant to consist of principal payments only or all cash flows – that is, both principal and interest. Further guidance might indicate that for the former (latter), undiscounted (discounted) estimates would make sense.

Convergence

FIRCA has supported efforts to improve accounting standards through convergence of U.S. Generally Accepted Accounting Principles (“US GAAP”) and International Financial Reporting Standards (“IFRS”). Accounting and reporting for financial instruments, including their impairment, is among the convergence projects that represent a critical step in the advancement towards a single set of accounting standards that will enable investors, businesses, and other interested stakeholders to evaluate, compare, and use financial data through a common language. Thus, FIRCA is concerned that the Proposal provides indications that the FASB’s and IASB’s final requirements on impairments for financial instruments will not be converged.

For example, while FIRCA appreciates the opportunity for timely feedback that a supplementary document facilitates, the Proposal indicates that FASB has not yet deliberated several aspects of what is being proposed. In addition, IASB expects to issue final guidance by June 2011, while FASB expects to finalize its guidance some time in 2011, but not by June 30th. Finally, the FASB and IASB supplementary documents do not exactly coincide. In particular, the IASB supplement includes a special appendix that proposes some additional presentation and disclosure requirements. These requirements appear to presume that the impairment requirements contained in the Proposal will apply to all financial assets carried at amortized cost, not just those assets managed in open portfolios.

All things considered, these differences suggest that the FASB and IASB final standards on impairments will not likely be converged. FIRCA encourages FASB and IASB to work toward a converged standard on impairments and not be distracted by arbitrary deadlines in doing so. The interests of all stakeholders are best served by the promulgation of accounting standards that will serve the test of time.

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Cross-Cutting Issues

FIRCA suggests that it would be helpful if the FASB and IASB address this project from the perspective of “cross-cutting issues.” For example, the proposed guidance on time proportional losses and the foreseeable future is inconsistent with tentative decisions that have been made on Insurance Contracts where the Boards are mandating the use of present value estimates together with risk margins for exposures that may not develop for decades (e.g., asbestos and environmental exposures). All stakeholders would benefit if the Boards could reconcile these diverse views.

Conclusions

In conclusion, FIRCA appreciates the opportunity to comment on the Proposal. FIRCA would also like to reiterate the importance of implementation considerations with regards to this Proposal. Consistent with FIRCA’s previous comment letters,² the FASB and IASB should engage in field testing to support that proposed guidance on impairments can be applied broadly and to identify and address any issues that would arise in implementing such guidance.

Thank you for your consideration and FIRCA stands ready to assist in these efforts.

Sincerely,
American Council of Life Insurers,
Commercial Real Estate Finance Council,
Council of Federal Home Loan Banks,
Group of North American Insurance Enterprises,
Mortgage Bankers Association,
Property Casualty Insurance Association of America,
The Real Estate Roundtable
The U.S. Chamber of Commerce

² For example, see March 25, 2011 letter from FIRCA to the FASB and IASB on *FASB Discussion Paper and IASB Request for Views on Effective Dates and Transition Methods* (FASB File Reference No. 1890-100).