

October 10, 2012

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

The Honorable Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Dear Chairmen Seidman and Hoogervorst:

The Financial Instruments Reporting and Convergence Alliance (“FIRCA”) is a coalition of nine trade organizations—American Council of Life Insurers, CRE Finance Council, Group of North American Insurance Enterprises, National Association of Real Estate Investment Trusts, Mortgage Bankers Association, Property Casualty Insurance Association of America, The Financial Services Roundtable, 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.

The mission of FIRCA is:

- To support the use of high quality, robust international accounting standards developed and adopted jointly by the International Accounting Standards Board (“IASB”) and the Financial Accounting Standards Board (“FASB”). These standards should be decision-useful, reliable, and relevant. Additionally, these standards should present financial information in a manner that reflects the business operations of the reporting entity. Appropriately crafted standards should transparently provide information and not drive economic activity.

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- To assist standard setters in providing a wide range of input to ensure the proper consideration of business operations and potential unintended consequences in the development and implementation of accounting standards.
- Recognizing the ongoing impacts of the 2008 financial crisis and continued currency pressures in the Euro Zone are global in scope and magnitude, we will continue to work with standard setters and decision makers to ensure that these projects are conducted jointly to ensure a comprehensive response to financial reporting policies.

We are writing to you today for two reasons:

One, you will find attached with this letter an updated set of our principles. These principles cover several aspects of the joint Financial Instruments project including: Classification & Measurement of Financial Assets and Financial Liabilities, Impairment, Derivatives and Hedging. We have updated these principles to reflect changes in the market as well as progress made by the Boards in their deliberations.

Secondly, we would request that both FASB and IASB rededicate themselves to the convergence process itself. We are writing today to express our concerns about the potential failure of the efforts to converge accounting standards and the consequences of a schism between the FASB and IASB.

We understand that the convergence projects have been going on for a lengthy time with a high level of activity that brings about a certain amount of stress and strain. This has been evidenced in some of the language used in public meetings and has suggested potential rifts that may prevent the ultimate completion of projects, or force the FASB and the IASB to go their separate ways.

Creating high quality standards to be followed on a global basis is not easy work and should be done with the utmost care. Nonetheless, the effort is worth it to make the first significant step to create a common financial reporting language for a global economy. This will help make our capital markets be more efficient and benefit investors and businesses alike.

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If convergence collapses, differing rules will cause confusion in the marketplace, restrict domestic and global capital formation causing negative ripples to wave across fragile economies around the world. This will cause an unlevel playing field that will obscure transparency and create arbitrage opportunities that will, in the end, impede capital formation for all participants in the marketplace.

FIRCA looks forward to continuing our efforts to work with the FASB and IASB to achieve our goals of robust accounting standards that reflect the economic activity of business operations in the furtherance of efficient and fair global capital markets.

Sincerely,

American Council of Life Insurers
CRE Finance Council
Group of North American Insurance Enterprises
National Association of Real Estate Investment Trusts
Mortgage Bankers Association
Property Casualty Insurance Association of America
The Financial Services Roundtable
The Real Estate Roundtable
The U.S. Chamber of Commerce

FIRCA Core Principles As of October, 2012

Overarching Premise

FIRCA supports the overarching premise that accounting and reporting for financial instruments should reflect both a reporting entity's business strategy and the characteristics of the financial instruments:

- Financial statements should help explain the business and its operations; and
- 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.

Financial instruments include debt instruments, derivatives, hybrid financial instruments and equity securities. A *debt instrument* is defined as having contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (P&I).

Financial Assets

Consistent with the premise that accounting and reporting for financial instruments should reflect a reporting entity's business strategy for the instruments and the characteristics of the financial instruments, FIRCA supports the following principles for classification and measurement of financial assets:

- Financial instruments held for trading purposes, including derivatives not associated with cash flow hedges, should be measured at fair value with periodic changes recognized in net income.
- Classification and measurement of financial instruments should be at fair value, including fair value with periodic changes in fair value recognized in other comprehensive income (OCI), or amortized cost based on the underlying business strategy for holding or issuing financial assets, which includes both the reporting entity's strategy for the financial assets as well as its business model.
- Financial assets that are not held for trading purposes should be permitted to be measured at either fair value with periodic fair value changes reflected in

OCI or amortized cost depending on the reporting entity's business strategy and characteristics of the instrument.

- For measurement at amortized cost, the financial asset would first need to be a debt instrument (meeting the 'solely principal and interest' criteria).
- If the financial asset is a debt instrument, measurement would be based on the following business strategies:
 - a) For assets where the primary objective is to be used for investing purposes that may result in the asset being either held for collection of cash flows or sold at a future date, the asset should be recorded at fair value with changes in fair value reflected in OCI.
 - b) For assets where the primary objective is to hold for collection of contractual cash flows whereby selling is permitted if it is still consistent with the objective of holding for collection of cash flows¹, the asset should be recorded at amortized cost or at fair value with changes in fair value reflected in OCI if it is more consistent with the reporting entity's business model.
- If the financial asset is not a debt instrument and not held for trading purposes, the measurement would be at fair value with changes in fair value reflected in OCI where amounts are recycled into net income upon being realized.
- The criteria for reporting at fair value with periodic fair value changes reflected in OCI or amortized cost should not preclude the ability to carry out prudent portfolio management or put at risk the future use of fair value with periodic changes in fair value reflected in OCI or amortized cost measurement bases. Reclassifications should be required if management's business strategy changes with respect to those assets reclassified.
- Hybrid assets with embedded derivatives should be bifurcated and reported separately using existing GAAP guidance. The remaining host should be measured considering the reporting entity's business strategy for the instrument (i.e., hold for collection or payment of cash flows or current settlement) and its business model.

¹ Examples of selling activity that would be permitted include interest rate mismatch, expected or potential credit deterioration, maturity/cash flow timing, and changes in exposure or credit risk

- The fair value option should be available in situations where financial assets and liabilities are managed together on a fair value basis or to prevent an accounting mismatch.

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 the decision to sell 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.
- Impairment changes should not be recorded at origination (no Day 1 losses should occur).
- Impairment recognition can be triggered by either an expected sale of an impaired financial instrument or a credit loss resulting from a 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 credit losses will be allowed, not to exceed cumulative previous credit losses identified.
- 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 decline in expected cash flows that has occurred since purchase of the instrument(s).
- If a financial instrument is evaluated individually for impairment, a pooled method is not required as a second step of the impairment evaluation.

Purchased Debt Instruments With Explicit Expectation of Credit Losses

Consistent with the impairment principles above, purchased financial assets with an explicit expectation of credit losses at acquisition should be presented in the statement of financial position at the transaction price without presentation of an allowance for expected cash shortfalls implicit in the purchase price.

For these purchased assets, no impairment loss should be recognized at acquisition. The purchase discount should be accreted from the purchase price to the expected cash flows. Any subsequent unfavorable change in expected cash flows should be recognized as an impairment loss in profit or loss. Favorable changes in cash flows expected to be collected should be recognized immediately in profit or loss as an adjustment to impairment expense even if the amount of such change exceeds the amount of previous impairment charges.

Financial Liabilities²

FIRCA believes that the current guidance in GAAP should be retained, which generally requires financial liabilities to be measured at their amortized cost basis that typically is equal to the contractual settlement value. At the same time, a fair value option should be available in situations where financial assets and liabilities are managed together on a fair value basis or to prevent an accounting mismatch.

Consistent with the overarching premise that accounting and reporting should reflect an entity's business model; FIRCA believes that amortized cost should be the default for financial liabilities based on business strategy, as it reflects the actual cash outflows expected to occur.

² Excludes liabilities included in the insurance contracts project

Derivatives and Hedging

FIRCA supports the following principles:³

- Derivatives may be used to hedge:

Exposures to changes in the fair value of a recorded asset or liability or an unrecognized firm commitment (fair value hedges);

Exposures to variability in the cash flows of a recognized asset or liability (cash flow hedges);

Forecasted transactions (forecasted transaction cash flow hedges);

Net investment in a foreign operation;

Foreign currency exposure present in other hedging relationships;

An entire asset or liability, a portion of an asset or liability, a portfolio of homogenous assets, a portfolio of homogeneous liabilities, or a specifically-identified risk inherent in an asset or liability.

- At inception and throughout a hedging relationship, the reporting entity should assess the hedge relationship's effectiveness to ensure the expected economic relationship continues between the hedging instrument and the hedged risk and that changes in fair value of the hedging instrument continue to be reasonably effective (as defined) in offsetting changes in the hedged risk, the variability in hedged cash flows, or foreign currency risk.

- We also support the use of qualitative not quantitative hedge effectiveness testing.

▲ The ineffective portion of a hedge should be recorded in earnings immediately.

▲ If requirements of hedge accounting are no longer met (e.g., the hedge is no longer effective), hedge accounting must be discontinued.

³ FIRCA also supports replacing "highly complex, quantitative-based" hedging requirements with more qualitative-based assessments.

- Hedging instruments may be de-designated and re-designated.
- Derivative assets and liabilities should be carried at fair value on the balance sheet.
- Embedded derivatives should be bifurcated from the host contract and accounted for separately if the economic characteristics and risks of the embedded derivative are not clearly and closely related to the host contract and the embedded derivative has the characteristics of a derivative.