



October 25, 2013

Susan M. Cospers  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

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

Dear Ms. Cospers:

Citigroup appreciates the opportunity to provide its views on the Financial Accounting Standards Board's (FASB) Exposure Draft of the proposed Accounting Standards Update, Insurance Contracts (Topic 834) (the "Proposed ASU"). We have confined our comments to the scope of the Proposed ASU and believe that many of the items within the scope should be excluded because the economic substance of the contracts are fundamentally different from that of typical insurance arrangements. While Citi supports FASB's effort to develop consistent accounting and reporting for insurance arrangements, we believe that because the Proposed ASU was prepared with insurers in mind, it is overly complex for non-insurers to apply and does not provide decision useful information for users of non-insurer financial statements.

The subsequent sections of this letter contain our more detailed observations. We would be pleased to discuss any of our comments at your convenience. Please feel free to contact me at (347) 648-7721.

Sincerely,

A handwritten signature in blue ink that reads "Robert Traficanti". The signature is written in a cursive, flowing style.

Robert Traficanti  
Deputy Controller and  
Global Head of Accounting Policy

### *Scope*

We do not agree with the scope of the Proposed ASU because its language causes certain banking products that have fundamentally different economics from traditional insurance contracts to be classified as insurance contracts. We believe that for such banking products existing literature (ASC 450 for contingencies, ASC 460 for guarantees and ASC 310 for Loans) should continue to apply. In the FASB's exposure draft (ASC 834-10-55-17) it states "Financial statements should reflect the economic substance of the contracts and not merely the legal form". We agree with this statement and clarify below why we believe that such banking products that have been scoped into the proposed standard have economically different substance to insurance contracts and should, therefore, be outside of the scope of the proposed standard.

### *Standby Letters of Credit*

A typical standby letter of credit involves a bank guaranteeing a payment on behalf of a client to fulfill a contractual commitment with a third party. In the event that the client fails to fulfill its contractual commitment, the bank will record a loan receivable from the client upon making payment to the beneficiary. In the table of examples provided in paragraph ASC 834-10-55-40 of the exposure draft, standby letters of credit have been scoped in as insurance contracts as an "obligation to the beneficiary on the part of the issuer".

Under the Proposed ASU, Insurance Risk is considered "significant" only if an insured event could cause an insurer to incur a significant loss in any single reasonably possible scenario. In a typical insurance arrangement, the payment of a claim by the insurer does not result in the insurer's contractual right to full reimbursement of the amount paid. In contrast, for many products included in scope of the Proposed ASU, standby letters of credit serving as one example, reporting companies will have recourse for full collection of the payment and would record a separate asset after making payment to the counterparty upon occurrence of the event. While it is possible that a reporting company would suffer a loss on said loan receivable (and thus may be considered to have accepted "significant insurance risk" as defined by the Proposed ASU), we believe that this arrangement is in substance an extension of credit rather than an insurance arrangement and the underlying risk of loss is more appropriately accounted for under existing literature on credit losses.

### *Liquidity Facilities*

Reasoning similar to the above can be applied to liquidity facilities. When a bank acts as a liquidity provider, investors have the right to tender their interests for purchase by the bank at a specified price. When the investor tenders its interest to the bank, the bank records the purchased interest on its balance sheet, often at significant value. This is again in contrast to typical insurance arrangements where the payment of a claim does not involve the insurer recording an asset.

The above products are similar in the fact that their economic substance is an extension of credit and the triggering event would result in an asset recorded by the financial institution. Therefore, we recommend the following language be included in the scope of the proposed standard:

*"Contracts that upon a triggering event result in the issuer recognizing a financial asset, such as a loan, are excluded from the definition of an insurance contract."*

### *Representations, Warranties and Indemnifications*

Financial institutions provide representations and warranties that certain assets conform to specified guidelines. For example, in a securitization transaction or whole loan sale, the seller typically makes representations and warranties that the assets transferred conform to specified guidelines or meet certain requirements. Typical examples of these representations and warranties include, among others: a) the transferor/seller's ownership of the loan; b) the validity of the lien securing the loan; c) the loan's compliance with applicable local, state and federal laws; and d) the absence of fraud. In the event of breach of its representations and warranties, the transferor/seller could be required to repurchase the subject loans or indemnify (make -whole) a third party for related losses.

Representations and warranties on securitized assets have been determined to be in scope of the proposed standard as noted in the table of guarantees on page 78.

We believe the securitization or whole loan sale representations are equivalent to those a product retailer would make in the product-warranty context. Specifically, paragraph BC41a provides that "Some warranties provide a customer with assurance that the related product complies with agreed-upon specifications. Those warranties do not meet the definition of an insurance contract because they are intended to ensure that the seller satisfied its performance obligation to the customer rather than to ensure that the seller provide compensation for an uncertain future event." We believe the arguments put forth in paragraph BC41a are applicable in the loan sale context, with the loan as the reporting bank's "product". Therefore, to include the related representations and warranties within the scope of the Proposed ASU while excluding product warranties is inconsistent. To include representations and warranties or any other recourse and indemnifications provided in relation to financial asset sales (securitizations) within the definition of an insurance contract would require changes to Topic 860-20 (Sales of financial assets). We do not believe it is the intent of the Board to make such changes. We believe that these representations and warranties are best handled as they are today under ASC 460 or ASC 860 depending on the transaction type.

It is also important to understand that in an insurance business, premiums for insurance contracts are generally determined through a complex system of risk analysis which involves predicting the probability of a loss given an insured event. Associated premiums are commensurate with the losses and risk assumed by the issuer. In contrast, representations, warranties and indemnifications do not have associated premiums and are incidental to the contract. Furthermore, the risk of related loss is remote. For example, in Citi's credit cards business, we have contracts with merchants to provide settlement of their credit card transactions. We earn a fee from the merchant based on a percentage of the credit card transactions settled. The economic substance of the transaction is providing a service to the merchant. However, as part of acting as a merchant's bank, we are also required to guarantee the performance of the merchant to the customer. If a customer purchases an item or service from the merchant and the purchased item is not satisfactorily received, and the merchant subsequently goes out of business or does not refund the customer's money, we are liable for returning the customer's money to them. Currently, these potential liabilities are measured under ASC 460 for guarantees. We do not have a direct, contractual guarantee with the customer, and we are not compensated for providing this guarantee. Rather, it is incidental to the overall contract of settling credit card transactions for the merchant.

We recommend the following wording be added as a scope exception:

*"Guarantees can be incidental to a contract and not representative of the underlying business purpose of the overall transaction. These types of guarantees are entered into based on the assessment that the risk of related loss is remote, and they represent a standard feature of similar contracts in the*

*marketplace. The issuer of the guarantee does not receive compensation for providing the guarantee. Because the economics of these types of transactions are not similar to an insurance contract whereby an insurer receives a premium commensurate with the losses and risks assumed, they are not determined to be insurance contracts within the scope of this standard.”*

#### *Guarantees related to Trust Preferred Securities (TPS)*

We do not agree that guarantees related to trust preferred securities are insurance contracts. In order to issue trust preferred securities, a financial institution will form a statutory trust company and will hold 100% of the common stock of the trust. The trust then issues preferred stock to investors. All of the proceeds from the issuance of preferred stock are paid to the financial institution. In exchange, the company issues junior subordinated debt to the trust with essentially the same terms as the trust's preferred stock. All steps except the formation of the trust occur simultaneously. Banks will also usually guarantee the interest and maturity payments on the trust preferred stock. Trust preferred security guarantees are in essence a guarantee of one's own debt or equity which is similar to the standard guarantee that an entity provides when issuing debt or preferred stock.

In paragraph 834-10-15-5, letter k, #2 in the exposure draft, the FASB has scoped out a guarantee or an indemnification of an entity's own future performance. In substance, the guarantee of a trust preferred security is a guarantee of an entity's own future performance and should not be considered an insurance contract.

#### *Catastrophe Bonds*

Catastrophe bonds are risk-linked securities that transfer specified risks from the sponsor of the bond to the investor. If the specified event does not occur, the investor receives a return of the principle invested plus interest. If the specified event does occur, there is a reduction in the amount of principle, interest or both made to the investor in the bond. The Board has concluded in its exposure draft that if a specified event adversely affects the issuer of the bond, the contract is an insurance contract. If the event is not specific to a party in the contract, the bond is outside of the scope.

Citi agrees that catastrophe bonds have features akin to insurance; however, we believe the fair value accounting recorded by investors for these bonds is most appropriate and useful for financial statement users. We also believe that a catastrophe bond investment is fundamentally different from a typical insurance arrangement. Unlike insurance contracts where the insurer receives premiums for the risk assumed, the insurer/investor would pay upfront for its investment in the bonds in order to receive the return. Because of their fundamentally different features and acknowledging the active secondary market that provides quoted prices for fair value measurement, we believe today's fair value measurement for catastrophe bonds, regardless if the issuer is adversely impacted by the specified event, is more objective, transparent, and useful for investors and users of financial statements compared to a probability-weighted mean of future cash flows.

#### *Clarifications Needed in the Proposed ASU*

- ASC 834-10-15-5, letter k #3 provides an exception on a guarantee that is both unusual or nonrecurring and unrelated to the type of risk that is the subject of other guarantees issued by the entity. This scope exception seems very subjective and might result in varying interpretation. In BC57c, it states “a seller's indemnification relating to a nonrecurring transaction, such as the sale of a business or an asset, often would be considered unusual or nonrecurring transaction. The Board decided that those transactions should be excluded from the scope of this proposed guidance

because the entity did not provide other such guarantees in the course of its normal business activities and, therefore, would not have the data and processes to measure the liability". We believe that more appropriate wording of the scope exception would remove the words "unusual or nonrecurring" and the exception would include: *"A guarantee that is not issued in the course of normal business activities of the entity."*

- ASC 834-10-15-5k excludes financial guarantees as an insurance contract if it does not expose the counterparty to risk throughout the contract term. This concept is further expressed in the guarantees table on page 76. As it is currently worded, the description of the scope exception is unclear. We believe it was the intent of the Board to scope out guarantees that would fail paragraph ASC 815-10-15-58c and therefore be accounted as derivative contracts under ASC 815. The exception for derivative contracts under ASC 815 is already captured by item j. However, if the Board wants to retain the specific guarantee exception, we propose the following wording: *"A guarantee contract that does not require the guaranteed counterparty, in order to receive payment on claims, to be exposed to risk throughout the term of the guarantee, that is, from inception of the guarantee contract and throughout its term either through direct legal ownership of the guaranteed obligation or through a back-to-back arrangement with another partner that is required by the back-to-back arrangement to maintain direct ownership of the guaranteed obligation"*. Also, certain types of financial guarantees (e.g. standby letters of credit) may result in an asset and thus, as discussed above, we believe these instruments should not be an insurance contract.
- ASC 834-10-55-40 Guarantees table on page 83 classified performance bonds as insurance contracts and performance guarantee as not insurance. This wording should be updated to clarify that guarantees of your own future performance are not insurance contracts. But rather, guarantees of a third party's performance to the extent they don't trigger the recognition of a financial asset, are intended to be within the scope of the proposed standard.

#### *Cost of the Proposed ASU*

Given the complexity of the Proposed ASU's accounting models, we expect that the implementation resources required for capturing the data, cost to develop new valuation models/systems, and modify the financial reporting architecture, to be significant for reporting entities. We believe these costs will be expended without achieving any benefit to the readers of our financial statements. We therefore urge the Board to exclude the banking products discussed above by including the language we have proposed in this letter.