

#### COMMITTEE ON CORPORATE REPORTING

## COMMITTEE ON CORPORATE TREASURY

September 1, 2010

Via email

Russell G. Golden, Technical Director File Reference No. 1810-100 Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116

Re: File Reference: No. 1810-100, Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815) – Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Dear Mr. Golden:

The Committee on Corporate Reporting ("CCR") and Committee on Corporate Treasury ("CCT") of Financial Executives International ("FEI"), appreciate the opportunity to provide their views on the Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (the "Proposed ASU").

FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. FEI's CCT formulates treasury policy for FEI in line with the views of the membership. This document represents the views of CCR and CCT and not necessarily the views of FEI or its members individually.

#### **Executive Summary**

CCR and CCT support the efforts of the Financial Accounting Standards Board (the "FASB" or the "Board") to comprehensively address the accounting for financial instruments. We are generally supportive of an impairment model that requires earlier recognition of expected credit losses and a simplified approach to accounting for derivatives and hedging. However, we are strongly opposed to the guidance in the Proposed ASU that requires the pervasive use of fair value as the primary measurement attribute, a credit impairment approach based on existing economic condition or historical data, and certain technical aspects of the proposed hedging model. Moreover, we do not believe placing such heavy reliance on fair value as the primary measurement attribute is supported by a majority of investors or financial statement users. In its current form, the requirements of the Proposed ASU will potentially have pervasive and adverse implications to all financial institutions, as well as many other commercial

organizations. We strongly urge the FASB to conduct extensive outreach to identify and understand the consequences of the proposed guidance and use the results in a new proposal.

Accounting for financial instruments is a component of the FASB and International Accounting Standards Board (the "IASB") joint project initiative under the boards' Memorandum of Understanding (the "MoU"). However, the Proposed ASU diverges in many significant respects from the classification and measurement, and credit impairment guidance proposed by the IASB. We believe that it is imperative that the FASB and IASB focus on developing a single converged financial reporting model for financial instruments. Anything short of that outcome creates an unlevel playing field between IFRS and US GAAP filers. Furthermore it will inevitably lead to other issues, including the potential of multiple implementations, for US GAAP filers if required to follow IFRS in the future.

Our specific comments related to our conceptual and operational concerns with the Proposed ASU are expressed below.

## Classification and Measurement

CCR and CCT strongly disagree with the fundamental premise that underlies the proposed guidance related to classification and measurements. Our concerns regarding the principles in the proposal include the following:

## 1. The majority of financial statement users do not support the proposed expansion of fair value

Users are more concerned with and give primacy to traditional performance measures such as credit loss experience, capital strength and prudent asset-liability management. While fair value information for financial instruments not traditionally accounted for at fair value could be useful (for example, to assess the value of an enterprise in the event of a merger or in times of financial distress), it is not the most relevant information available and therefore it should not be used as the primary measurement attribute in the financial statements. Rather it should be provided to users through supplemental disclosure along with qualitative information that would provide context for a full understanding. We acknowledge that certain representational organizations for financial statement users support fair value as the primary measurement attribute in the financial statements, which we understand is a major reason for the FASB's proposed model. However, we do not believe these such views fairly reflect those held by the majority of investors or traditional analysts as we are aware of a broad range of users that do not favor this approach. Independent surveys performed by PricewaterhouseCoopers<sup>1</sup> and Barclays<sup>2</sup>, as well as discussions our member firms have had with their equity analysts, indicate that the majority of investment professionals do not support fair value as the default model. Moreover, the FASB should not disregard the views of financial statement preparers, which oppose the fair value model on the basis of both relevance and cost. Given that the overwhelming majority of financial statement users and preparers do not support the principles in the Proposed ASU, we recommend that the FASB reconsider its decision to require fair value as the primary measurement attribute in the financial statements.

## 2. The entity's business model is integral to the classification and measurement of financial instruments

CCR and CCT are strong proponents of an amortized cost model for financial instruments that are held for their contractual cash flows and support the IASB's approach in this regard. Such a model ensures both accounting and economic symmetry between financial assets and liabilities because it inherently considers an enterprises' business model (how the financial instruments will be managed to produce

<sup>&</sup>lt;sup>1</sup> Pricewaterhouse Coopers Survey: What Investment Professionals Say About Financial Instrument Reporting, June 2010

<sup>&</sup>lt;sup>2</sup> Bardays Capital Survey: Bank Brief Newsletter Survey, June 2010

returns for investors). For these reasons, amortized cost remains the most relevant measure for financial assets held for investment or managed for the foreseeable future. We believe an amortized cost model, coupled with the right credit impairment and interest income recognition guidance and supplemental quantitative and qualitative disclosures, will better align accounting with the metrics used to evaluate the performance of such financial assets. In cases where the business strategy is to hold the financial asset, we believe fair value will result in artificial volatility that will not be realized; as such, fair value would not reflect economic reality. Therefore, we fail to see the benefit of measuring financial assets at fair value in the primary financial statements. Likewise, amortized cost is the most relevant measure for financial liabilities, such as deposits and most other forms of a company's own debt, which may also be used to fund these assets. The IASB proposal recognizes the relationship between an enterprise's business model and the selection of principles for classification and measurement of financial instruments. In contrast, the model proposed by the FASB appears to take a "one size" fits all approach by adopting principles that are only appropriate when an entity plans to trade or engage in short-term monetization strategies for certain financial instruments. We encourage the FASB to conform its proposed guidance to the overall framework in IFRS 9 issued by the IASB with some modifications.

## 3. Reliable financial information is paramount to effective financial reporting

Many of the financial instruments that would be measured at fair value under the proposed guidance have no discernible market in which to determine fair value, such as mortgage loans and private equity investments. Accordingly, the determination of fair value for these instruments would be based on "Level 3" valuation techniques. The introduction of these highly subjective valuations will compromise the integrity of reported results, reduce investor confidence and encourage speculation. The FASB implicitly acknowledged these concerns when it issued FSP FAS 157-4 (the "FSP")³ in April 2009. The FSP was issued to address the difficulties related to the determination of fair value in inactive markets, which at that time, related primarily to debt securities that initially traded in very active markets. Given these concerns about reliability, the practical difficulties associated with determining fair value for "Level 3" financial instruments, as well as the likely adverse impacts to companies, we do not believe the proposed fair value guidance improves financial reporting.

In addition, financial statement users will have to rely more heavily on disclosures for them to make assessments of how the fair value was estimated and, after removing the effect of such fair value from the financial statements, determine the true performance of the company. While fair value may be an informative data point for users, we understand that is not the key metric for evaluating an entity's cash flows when the financial asset is being held for the long-term. We also understand from users that fair value is stale by the time financial statements are issued, and as a result, not as meaningful.

If the requirements are finalized as proposed, "Level 3" balances will grow significantly for certain entities, including, financial institutions and other entities with longer term investing and financing activities. The Board should consider the consequences of the significant growth of "Level 3" assets on its recently issued proposal on disclosures related to measurement uncertainty for "Level 3" assets. We have significant concerns with the relevance of the proposed disclosure as well as with the operationality of preparing the information, particularly where such information is not (and will not) be used as part of existing risk management processes. We believe that the costs would clearly exceed the perceived benefits, with particular burden on entities that may be reporting "Level 3" balances for the first time. In order to address concerns regarding transparency of the valuation of "Level 3" assets, we believe that information related to uncertainty around valuation inputs would be more meaningfully presented through

<sup>&</sup>lt;sup>3</sup> FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly

qualitative disclosure of valuation inputs and methodologies; valuation practices; and controls around such practices, including processes undertaken to validate estimates.

## 4. <u>Augmenting the credit impairment model will provide adequate transparency to the risks associated</u> with financial instruments

The requirement to measure all financial instruments at fair value commingles and obscures one of the more significant risks to financial instruments, credit risk, with other market factors that may be significantly less relevant for most enterprises that intend to hold financial assets to maturity or the foreseeable future. CCR and CCT acknowledge that the credit market disruption experienced in 2008 highlighted the need for more transparency related to the risks associated with financial instruments, despite an existing accounting model that already requires the measurement of many financial instruments at fair value. In the Basis for Conclusions of the Proposed ASU the Board states, the use of fair value accounting imposes market discipline because it forces an entity to cope with current market conditions (especially in times of market turmoil, when fair value measurement of all financial instruments would serve as an "early warning system"). However, this logic is fundamentally flawed. The credit market disruption highlighted that markets are not always efficient or rational. We observe that fair value declines were not an accurate indicator of credit losses, as some proponents of the fair value model like to assert. In many cases such declines have subsequently reversed as transparency and stability returned to the markets. Accordingly, over reliance on fair value will inevitably cause financial statement users to draw incorrect conclusions about the strength of an otherwise healthy enterprise. A comprehensive credit impairment model that requires earlier recognition of expected losses should adequately address user concerns about exposure to financial instruments. Concerns about exposure to liquidity and other market risks should be provided to users through disclosure.

## 5. The settlement amount should be the default measurement for non-derivative financial liabilities

Earnings effects related to changes in own credit risk produce counterintuitive results that often confuse investors and other users of financial statements. Because these changes present quality of earnings issues, analysts and investors often disregard these changes when they analyze reported and future performance results. In addition, the requirement to separate changes in the price of credit from a company's own credit risk is conceptually flawed. Changes in credit grades, as well as the price of credit, are components of overall credit risk. In fact, changes in the price of credit are, in certain instances, leading indicators of overall credit risk. This represents another area where the FASB's proposed guidance diverges significantly from the IASB's proposed guidance. The IASB proposal provides for a fair value option for non-derivative financial liabilities. If an entity elects the fair value option, changes in own credit are recorded in other comprehensive income. The IASB model does not permit recycling of gains and losses due to changes in own credit. We strongly encourage the Board to conform the proposed guidance to the IASB guidance.

## 6. Narrowing the scope of the equity method of accounting is not appropriate

CCR and CCT do not agree with the proposal to limit the use of the equity method of accounting to investments that are "related" to the entity's consolidated business for the following reasons:

- The expansion of fair value measurement to equity method investments will generate significant interpretive issues that likely will create diversity in practice, resulting in different accounting models for similar (strategic, long-term oriented) equity method investments. This will reduce comparability, create additional burden on preparers and auditors, and result in less meaningful information for users of the financial statements.
- Accounting for investments that would otherwise require equity method accounting were it not for the related criteria at fair value is inconsistent with the proposed guidance from the IASB and therefore

creates an additional and unnecessary difference that will potentially need to be converged in the future.

- Consolidation of all entities where control is present is required regardless of differences between the parent and subsidiary's business operations. Since equity method accounting is "one-line consolidation", equity method accounting should be required where significant influence is present and the nature of investment is for long-term strategic purposes, regardless of differences in business operations.
- Applying the related criteria for investments in voting interest entities but not for investments in variable interest entities creates an unnecessary inconsistency in the equity method accounting rules.
- The proposal will adversely affect the reliability of reported results. Many of the valuations for these investments would be based on "Level 3" valuation techniques. Moreover, valuation assumptions may be based on stale information due to typical lags in the availability of financial data.

## Credit Impairment and Interest Income Recognition

CCR and CCT are generally supportive of an impairment model that requires earlier recognition of expected credit losses. However, there are significant operational and conceptual issues associated with the proposed credit impairment model. Our concerns regarding principles in the proposal include the following:

1. The consideration of future conditions or events is a necessary component of the determination of expected credit losses

CCR and CCT do not agree with the Board's decision to prohibit the consideration of future events and conditions when determining the amount of expected credit losses. Investors rely on management to develop their best estimate of credit losses. In practice, such estimates are based on historical and current economic trends, published statistical data, borrower specific data, and reasonable forward looking expectations. The proposed calculation of expected credit losses differs fundamentally from the inherent expected cash flows that underpin the fair value of financial instruments, as well as a market participant's overall view of credit risk. The notion of expected credit losses, whether based on expected cash flows, statistical data or implicit in a quoted price, inherently considers how expectations of future economic conditions affect current and historical conditions. Determining and reporting credit losses based on a static or historical view of credit exposure will cause an enterprise to misstate its exposure to credit risk and result in credit loss reserves that lag changes in the credit cycle.

## 2. Further simplification of the credit impairment model is necessary

Depending on the nature of the financial asset, the credit impairment model requires the use of historical loss rates or expected cash flows to determine expected credit impairment. For many asset classes, expected credit losses are and can be determined using statistical and historical data, combined with reasonable expectations about future economic conditions, rather than complex expected cash flow estimates. We urge the FASB to allow companies to utilize this data in lieu of expected cash flow estimates to determine credit impairment. Such an approach will significantly simplify the determination of credit impairment, provide similar results, and remain faithful to the principles in the Proposed ASU.

In addition, although based on expected cash flows, the proposed model requires a separate reserve methodology for purchased financial assets. In a credit impairment framework based on expected cash flows, the FASB recognized that it is no longer necessary to separately distinguish purchased credit impaired financial assets. Accordingly, we do not believe there is a conceptual basis to differentiate

between originated and purchased financial assets. To further simplify the credit impairment framework, we recommend that the Board develop a single model for both originated and purchased financial assets.

## 3. Further evaluation of alternative credit impairment models is necessary

Multiple alternative models for credit impairment have been proposed by the IASB, the Expert Advisory Panel (the "EAP") of the IASB, and other constituent groups. While we do not agree with many of the aspects of the FASB proposal, we are currently unable to support any of the alternative impairment models at this time. We urge the Board to evaluate the alternative impairment models offered by the IASB, EAP and other alternative models offered by industry participants and regulators. We strongly believe that it is necessary for the FASB and IASB to jointly conduct more comprehensive outreach with affected constituents and further analysis of the impact of the requirements in order to fully develop an effective and operational credit impairment model. We further believe that any revised model should be vetted with thorough additional due process steps prior to issuing a final converged standard.

The proposed credit impairment models provide for either immediate recognition of credit losses, spreading such recognition over time, or a combination of both immediate recognition and spreading over time. While CCR and CCT have not reached a consensus on which of the models (or components thereof) is preferable, we plan to study this area further and may provide further comments prior to the round table discussions in October 2010. As the FASB and IASB undertake the process of assessing the merits of the alternative models, we wish to emphasize that an effective and operational credit impairment model should have the following core attributes:

- Represents management's best estimate of expected losses that requires the use of future events and conditions;
- Does not require the use of expected cash flows to estimate expected losses;
- Decouples the recognition of interest income from the allowance for credit losses;
- Provides symmetry in accounting for subsequent changes in expected credit losses; and
- Removes the "probable" trigger, resulting in earlier recognition of expected losses.

# 4. The proposed calculation of interest income is not operational and will produce counterintuitive results

CCR and CCT do not support calculation of interest income by applying the effective interest rate to the amortized cost balance net of the allowance for credit losses. Operationally, the allowance method prescribed for pooled assets is fatally flawed because it may require the allowance for credit losses to be allocated and maintained at the individual asset level or various levels of aggregation. Accordingly, this change would require significant and costly system changes to accommodate this new recognition model. For those companies that maintain and prepare financial information on another basis of accounting to comply with regulatory reporting requirements, such as insurance companies, in-house and/or third party systems do not have the capability to apply multiple income recognition methodologies to the same financial asset.

Conceptually, we share the concerns of certain of the Board members described in the Alternative Views section of the Basis for Conclusions as the proposed calculation of interest income will produce counterintuitive results. For example, the interest income methodology will understate interest income and overstate recoveries for performing assets because cash interest will almost always exceed the proposed calculated interest income as well as credit allowance requirements. Accordingly, the excess allowance created by this approach will need to be reversed through the provision for credit losses. Another concern is the calculation of interest income will be inconsistent with financial assets measured at fair value through earnings.

We strongly support maintaining the practice of recognizing interest income for performing assets based on the amount contractually due (adjusted for any net deferred loan fees or costs, premium or discount existing at the origination or acquisition). Upon impairment, the calculation of interest income should be based on the premise that accrual is appropriate to the extent cash flows are expected to be collected.

## **Derivative and Hedge Accounting**

CCR and CCT are supportive of a simplified approach to accounting for derivatives and hedging. The proposed changes are a positive move towards simplification, should increase the number of hedging relationships that qualify for hedge accounting, and should help improve the comparability of financial statements. However, there are several areas that require improvement, which are described below.

# 1. Additional guidance is needed regarding the assessment of whether a hedging relationship is reasonably effective

The proposed changes will create interpretive issues regarding the definition of "reasonably effective" and when a quantitative assessment of effectiveness is necessary. Without additional guidance, there may be an implicit requirement for preparers to perform quantitative assessments to avoid "second guess" risk or to prove the qualitative assertions. The Basis for Conclusions notes that the need for quantitative assessments should be rare. However, we believe the final standard should explicitly remove the quantitative analysis from the determination of hedge effectiveness. The FASB took a similar position in FAS 167<sup>4</sup> with respect to the determination of the primary beneficiary in a variable interest entity. In FAS 167, the FASB acknowledged that retaining the quantitative analysis for the determination of the primary beneficiary will inevitably lead to the widespread use of a quantitative test as a means to "prove" the qualitative assessment. A qualitative-only approach will be more effective in determining effectiveness and further simplify the hedge accounting model. Such guidance would ensure that quantitative assessments are only applied in very rare circumstances when management's judgment indicates the need to support or supplant the qualitative assessment.

## 2. The calculation of ineffectiveness for plain-vanilla hedging strategies should be simplified

While the proposal to reduce the threshold for assessing effectiveness is helpful, there remains a significant operational burden associated with the calculation of ineffectiveness. The short cut and matched terms methods allow companies to easily apply hedge accounting to typical and common hedging strategies (e.g., fair value hedges of fixed rate debt or hedge of foreign currency purchases and sales) without incurring significant costs for additional resources and complex valuation and risk systems. Although these methods are overly rules-based and have been the source of interpretation risk and restatements for many companies, they are very practical for assessing effectiveness and calculating ineffectiveness during the term of a hedge relationship. The existing long haul calculation methods require entities to include the impact of credit spreads that can result in the calculation of more ineffectiveness than is reflective of the economics of these highly effective hedging relationships.

Hedging relationships should not result in greater ineffectiveness simply because credit spreads on the hedged item widen. The method permitted under IFRS to hedge only the portion of the cash flows associated with the hedged risk simplifies this calculation while capturing a more appropriate measure of hedge ineffectiveness. The IFRS method does not consider credit spreads. It only considers the interest rate components that have been designated in the hedging relationship. This approach has been an element of IFRS hedge accounting for years and has proven to be a useful and operational method for preparers following IFRS. Given the objective of this project is a converged standard, we think it would

<sup>&</sup>lt;sup>4</sup> Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation FIN 46(R)

be particularly important for the FASB to incorporate this concept into the final standard. We strongly encourage the FASB to address the problems and operational difficulties associated with calculating ineffectiveness under the long haul method, especially for simple hedging relationships, before requiring its use. As an alternative, the Board could provide some practical expedients to aid in the implementation of the standard for those less-complex hedging strategies that are unlikely to generate significant ineffectiveness.

## 3. De-designation is a prudent and cost-effective risk management strategy

CCR and CCT strongly disagree with the proposed prohibition on voluntary de-designation of hedge accounting relationships. The assumption that preparers will simply terminate or offset hedging relationships in lieu of utilizing de-designation does not reflect the business realities and significant incremental costs of doing so and fails to recognize that such actions do not provide the entity with any measureable economic benefit. Hedging the risks embodied in large portfolios of financial assets or liabilities is inherently a dynamic process. As economic conditions change, the risk profile of the hedged exposure may be affected. Accordingly, it may be necessary to enter new hedging relationships and exit, or de-designate, existing hedge relationships to properly manage exposures to the hedged risk.

The objective of dynamic hedging strategies is to promote effective risk management by ensuring the hedging relationship contemplates the changing economic conditions of the hedged item. Prohibiting dedesignation runs counter to the principle that qualifying hedge accounting strategies must be effective. The FASB expressed a concern that these valid risk management strategies may be used by an enterprise to "manage earnings". However, this concern is misguided and unwarranted as de-designations and redesignations must be documented contemporaneously and therefore in advance of any anticipated market movements. As such, it is not possible for management to manipulate earnings, as the impact of dedesignating a hedge can only be felt prospectively. Providing enhanced disclosure requirements about why and how companies use de-designation strategies would better address the FASB's and user concerns rather than mandating a prohibition on hedge accounting for these strategies.

Furthermore, the proposal is unclear as to whether net investment hedges are affected by the elimination of voluntary de-designations. Due to the nature of the underlying, net investment hedges often involve strategies that include de-designation and re-designation of both derivative and non-derivative instruments. Accordingly, we believe the final standard should specifically exclude net investment hedges from the prohibition against de-designation/re-designation strategies.

## 4. Bifurcation by risk for non-financial elements should be permitted

We strongly support the continuation of the bifurcation by risk approach in the Proposed ASU. However, we believe the FASB should extend this approach to cover other types of risks that can require hedge accounting and are difficult to achieve in practice. Companies have significant exposures to market risks in the ordinary course of business that historically have been difficult to qualify for hedge accounting, such as a commodity component of a supply contract. The inability to hedge risk exposures in a non-financial contract can result in significant unnecessary accounting and economic asymmetry for otherwise valid and effective economic hedges. Accordingly, we believe the guidance should be amended to allow companies to define a non-financial risk component that is observable and reliably measurable as the hedged risk.

## 5. Bifurcation of embedded derivatives is necessary to maintain effective economic hedging strategies

We disagree with the FASB's proposal to initially and subsequently measure all hybrid financial assets and liabilities at fair value if they contain embedded derivatives that would otherwise require bifurcation

under Topic 815. Such a requirement is not consistent with the risk management strategies employed for these instruments and accordingly, will exacerbate accounting measurement mismatches. For example, companies may use free-standing derivatives to economically hedge bifurcated derivatives, which are typically the primary source of a hybrid instrument's variability. If the entire hybrid instrument is subsequently measured at fair value, the free-standing derivative will not be effective at offsetting the risks of the embedded derivative. We do not believe the FASB's proposed guidance for hybrid instruments represents an improvement in financial reporting. Rather, we believe it would be more appropriate to account for the host contract in accordance with the business strategy for the entire hybrid instrument rather than defaulting to fair value through earnings. Such a model would promote consistency with other non-hybrid instruments with similar business strategies. Accordingly, the proposed guidance for hybrid instruments should be modified to provide preparers an option to either bifurcate embedded derivatives or measure hybrid instruments at fair value with changes in earnings. If the FASB does not permit bifurcation, then the final standard should include guidance that exempts a company from having to measure the entire instrument at fair value through earnings solely because of a de minimis embedded derivative.

## 6. The transition guidance should "grandfather" certain hedging relationships

If the FASB does not accept our recommendations on hedge accounting, we recommend that the final standard only require prospective application of the proposed hedge accounting provisions to hedging relationships that exist as of the implementation date. Certain hedge accounting relationships that exist at the implementation date will be eliminated and application of the transition guidance would require companies to assess and measure hedge effectiveness for historical periods for which information may be difficult or impractical to obtain. Furthermore, we are unclear how the transition guidance would be applied to previously de-designated and re-designated hedging relationships.

## Presentation and Disclosure

CCR and CCT are concerned about the current and proposed level and volume of disclosure for financial instruments. Our specific concerns are discussed below.

#### 1. The proposed presentation requirements will obscure the face of the financial statements

The proposed new presentation requirements obscure the face of the financial statements with extensive disaggregation that will detract from the relevant financial measures. We recommend changing the provisions in the Proposed ASU to provide the following information in the footnotes rather than on the face of the financial statements:

- Financial assets and liabilities based on measurement model;
- Reconciliation of amortized cost to fair value for instruments measured at amortized cost or at fair value through other comprehensive income;
- Interest income, credit impairments and realized gains or losses for financial instruments measured at fair value through other comprehensive income;
- Significant changes in the fair value of own debt arising from changes in own credit.

Clear, concise, and adequate presentation and disclosure is vital to high quality financial reporting. Accordingly, providing this information through footnote disclosure will satisfy the needs of users without overwhelming them with detail on the face of the financial statements.

# 2. The FASB should simultaneously and comprehensively address all the disclosures for financial instruments

With this exposure draft, the FASB is looking to overhaul the recognition and measurement of all financial instruments, therefore, we urge the FASB to also use this opportunity to take a fresh look at all of the disclosures related to financial instruments to eliminate redundancies and provide the most decision useful information.

Based on discussions with users of our financial information (including our colleagues from investor relations), we believe that disclosures under this model should place greater emphasis on average duration and credit ratings (e.g., investment grade versus non-investment grade) and less on maturities. Additionally, as the FASB moves away from yield-related impairments, disclosures involving securities in an unrealized loss position lose their relevance. These disclosures instead should be replaced with the proposed disclosures related to credit impairments. However, we disagree with disaggregating the rollforward of the activity of credit impairments separately for financial assets assessed individually or on a pooled basis. By modifying current disclosures, we believe that users will find this information more relevant and useful.

## Other Concerns with the Proposed ASU

We have the following general comments about the Proposed ASU:

## 1. The implementation costs and control risks do not justify the perceived benefits of the Proposed ASU

Currently, existing accounting systems cannot accommodate the proposed fair value and credit impairment guidance. For example, loan accounting systems cannot track fair value separately from amortized cost, calculate and store expected cash flow information or handle the proposed changes to interest income recognition. Accordingly, the proposed guidance will require companies to significantly enhance or in certain cases, replace entire financial reporting systems. Given the complexities and significant implementation costs associated with the proposed guidance, it may ultimately be necessary to address reporting deficiencies "off-line" with manually-intensive processes, such as ad-hoc database or spreadsheet tools, to augment the existing IT infrastructure. Accounting for significant components of an enterprise's balance sheet in this manner will severely stress the control environment, which will cause organizations to be susceptible to an increase in financial statement errors. Given these and the other operational and conceptual weaknesses that we have identified throughout this letter, we do not believe the perceived benefits have been sufficiently demonstrated to justify an undertaking of this scale and cost.

## 2. Proper field testing will identify any unintended consequences of the Proposed ASU

We strongly urge the FASB to conduct proper field testing, with appropriate industry representation, to identify and understand the consequences of the proposed guidance. Unintended consequences of the proposed guidance may adversely impact access to credit or equity markets, cost of capital, availability of consumer and commercial credit, as well as certain business and risk management strategies employed by management. As part of the field testing, the FASB should also consider the IASB proposed guidance for classification and measurement, credit impairment and the upcoming proposed guidance on hedging. Lastly, the FASB should also conduct field testing with industry and other financial regulators to determine whether the proposed guidance increases systemic risk for a particular industry. Understanding the systematic and systemic consequences of the proposed guidance is paramount to effective standard setting and high quality financial reporting. Given the potential widespread implications of the Proposed ASU, we strongly encourage the FASB to re-expose the proposed guidance based on issues raised during the field tests for additional comment prior to final issuance.

## 3. The lack of successful convergence on this project is discouraging

CCR and CCT support the convergence efforts of the FASB and IASB. Accounting for financial instruments is a pervasive issue for all organizations and it is imperative that the regulatory and accounting framework provide a level playing field for all market participants. However, to date, the FASB and the IASB have been unable to converge their respective proposals on fair value measurement and credit impairment. Given the magnitude of the Proposed ASU and the aggressive pace and extent of change associated with the remaining MoU projects, we do not understand the FASB's decision to issue the Proposed ASU prior to the completion of its convergence efforts. The FASB cannot reasonably expect preparers to evaluate multiple proposals by the two Boards or require a multi-step implementation of the same standard as a bridge to ultimate convergence. The process to generate high quality financial reporting standards must afford sufficient time to preparers to evaluate the nature and extent of the proposed changes as well as the knowledge that such standards will not be subject to change in the foreseeable future.

# 4. The proposed changes to the Codification are necessary to fully evaluate the impact of the Proposed ASU

To fully assess the impacts and potential unintended consequences of the Proposed ASU, the FASB must expose the proposed amendments to the Codification. Although the content of "Appendix C: Summary of Proposed Amendments to the FASB Accounting Standards Codification" provides a general idea as to the areas of current accounting guidance that will be impacted, the specific amendments are needed to truly evaluate the extent of these changes.

## 5. A decision on the effective date should be made jointly with the SEC

Any decision on the effective date should be made in conjunction with the U.S. Securities & Exchange Commission (the "SEC"). Recently, the SEC reaffirmed its IFRS roadmap. With this decision, the governing agency has a substantial stake in the success of the implementation of any converged standards in the U.S. Consequently, a decision on effective date of any converged standards should be delayed until the SEC has a resolution on its path of convergence or conversion.

## 6. The transition guidance for guarantees should be clarified

Guarantees issued prior to December 31, 2002 were excluded from the initial recognition and initial measurement provisions of FIN 45<sup>5</sup>. It is unclear in the Proposed ASU whether the FASB intends to carry forward this transition guidance. We encourage the FASB to clarify its intention. Further, consistent with FIN 45, we recommend that the initial recognition, initial measurement and subsequent measurement guidance of the Proposed ASU apply only to guarantees that are issued or modified after December 31, 2002.

#### 7. The scope of the Proposed ASU may impact other projects on the Board's agenda

CCR and CCT recommend that the FASB review the assets and liabilities affected by proposed standards that could be issued under other active projects to ensure that the impact of this standard is considered and

<sup>&</sup>lt;sup>5</sup> FASB Interpretation No. 45 (FIN 45), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others – an interpretation of FASB Statements No. 5, 57 and 107 and resassion of FASB Interpretation No. 34

deemed appropriate. Examples include receivables created under the revenue recognition project as well as assets and liabilities recognized under the revised leasing model.

We also believe that the FASB should actively consider whether applying the impairment guidance to instruments that otherwise meet the definition of a financial instrument but are neither loans nor securities (e.g., receivables generated by industrial and service companies in the ordinary course of business) is appropriate and necessary. We believe that this may be inordinately burdensome for many non-financial services companies and question whether it would improve their financial reporting to investors.

## Conclusion

While we support the FASB and IASB convergence efforts, we are strongly opposed to many of the provisions included in the proposed ASU, including the pervasive expansion of the use of fair value, the inability to consider future events in the estimation of expected credit losses, and the overall lack of consistency between the proposal and an enterprise's business strategy. The Proposed ASU will reduce the reliability of financial reporting and introduce significant operational complexity. Given these concerns and our belief that the expansion of fair value is not favored by the majority of financial statement users, we strongly encourage the FASB to delay the final issuance of the Proposed ASU until a single converged financial reporting model for financial instruments is developed.

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CCR wishes the opportunity to participate in one of the round table sessions for the Proposed ASU in October 2010. Please contact Lorraine Malonza at 973.765.1047 or lmalonza@financialexecutives.org with any questions.

Sincerely,

Loretta V. Cangialosi

Chairman, Committee on Corporate Reporting

Lorde Congralor

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Susan Stalnecker

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