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Submitted via electronic mail to director@fasb.org

# File Reference No. 1810-100, Exposure Draft: Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Dear Mr. Golden:

Intel is pleased to respond to your request for comment on the Exposure Draft, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. We support the FASB's objective to improve the decision usefulness of financial instrument reporting by providing users with a more timely and representative depiction of financial instrument activities while reducing the complexity in accounting for financial instruments. The proposed model can better achieve these objectives by allowing financial assets to be recognized based upon how an entity manages its business, providing a more principles-based approach to the measurement and classification of financial liabilities, and removing the preclusion from de-designating and re-designating hedge relationships. Our suggestions are further explained in the following paragraphs; detailed responses to the questions presented in the Exposure Draft are included in an Appendix to this letter.

# Changes in the Fair Value of Financial Assets Through Net Income Could Result in Misleading and Inappropriate Volatility

Our goal is to be the preeminent provider of semiconductor chips and platforms for the worldwide digital economy. We generate most of our cash flows by manufacturing and selling semiconductor chips and platforms, which constitute our ongoing central operations. We also have a significant investment portfolio. Our philosophy for our cash and marketable debt instruments is to preserve principal while maximizing yields. Our investment philosophy for our equity portfolio is to further our strategic objectives and support our key business initiatives. Despite the significance of our financial assets and liabilities, our business strategies are such that the majority of our cash flows are generated

by manufacturing and selling semiconductor chips and platforms rather than from the realization of gains and losses on our financial instruments.

The Financial Instruments project would require more financial assets to be measured at fair value with changes in value presented in net income regardless of an entity's business strategy with respect to those financial assets. We recognize that the classification of changes in the value of financial assets in net income would provide investors with decision useful information for entities that are in the business of trading financial instruments. However, given our strategic objectives and the nature of our operations, the recognition of fair value changes in net income would result in misleading and inappropriate volatility because these changes do not represent realized cash flows representative of our core cash generating activities.

The model proposed by the International Accounting Standards Board permits an entity to classify financial assets on the basis of both the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. An entity is able to make an election to recognize changes in fair value outside of net income for investments in equity instruments that are not held for the purpose of trading. We support the IASB's model and believe that by providing qualitative disclosures on both the classification and measurement of financial assets and how they align with management's intent and strategy, investors will be provided with appropriate information to make informed decisions.

# Measuring Financial Liabilities at Fair Value May Create or Exacerbate a Measurement Attribute Mismatch

We believe that measuring financial liabilities at fair value and classifying the changes in net income may create or exacerbate a measurement attribute mismatch. In BC111, the Board recognizes that there is merit to this argument, but believes fair value is the appropriate measurement in situations in which the majority of an entity's assets are measured at fair value. In acknowledgment of circumstances where fair value measurement would not provide decision useful information, the Board has provided specific criteria that, if met, would permit recognition of fair value changes outside of net income. However, these criteria create bright lines that do not consider the nature of an entity's operations or allow for the exercise of judgment by management.

Due to the nature of our operations, we have significant unrecognized assets. As a result, the volatility created by measuring our financial liabilities at fair value would not be offset by the changes in the fair value of our unrecognized assets. Consequently, recognizing financial liabilities at fair value through net income would decrease the predictive value of the information provided to investors. The criteria for classification of changes in fair value of financial liabilities outside of net income needs to acknowledge that, regardless of the size of an entity's financial assets, measuring financial liabilities at fair value may create or exacerbate a measurement attribute mismatch. We propose that the Board adopt a more principles-based approach to the measurement and classification of financial liabilities to reflect an entity's operations and management's strategic intent for the entity's financial liabilities. This approach will promote the Board's objective of improving the decision usefulness of financial instrument reporting.

# The Preclusion to De-Designate and Re-Designate a Hedge Adds Unnecessary Complexity and Cost

The Exposure Draft reflects significant improvements to the existing guidance on hedge accounting which should provide operational efficiencies for entities. We are concerned, however, about the proposed requirement that precludes an entity from de-designating and

re-designating fair value or cash flow hedges. The Board expects that an entity will be able to achieve the same accounting under the Proposed ASU that is achieved under current guidance; however a company will be required to enter into more hedging contracts, increasing administrative burden and transaction costs related to hedging activities. We recommend that the Board remove the restrictions rather than increasing both the operational and cost burdens.

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Thank you for your consideration of the points outlined in this letter. If you have any further questions or would like to discuss our responses further, please contact me at (971) 215-7931, or Liesl Nebel, Accounting Policy Controller, at (971) 215-1214.

Sincerely,

James G. Campbell

Vice President, Finance Corporate Controller Intel Corporation

# **Appendix**

## **Questions for Respondents**

### Scope

Questions for All Respondents

Question 1: Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments do you believe should be excluded or which financial instruments should be included that are proposed to be excluded? Why?

We agree that the scope of the proposed Update is appropriate given the project objective of comprehensively improving financial instrument reporting for users of financial statements. However, we understand that it may be necessary to efficiently address some constituent concerns by amending the scope.

Question 2: The proposed guidance would require loan commitments, other than loan commitments related to a revolving line of credit issued under a credit card arrangement, to be measured at fair value. Do you agree that loan commitments related to a revolving line of credit issued under a credit card arrangement should be excluded from the scope of this proposed Update? If not, why?

We defer to respondents with credit card programs for input on the appropriateness of the proposed exclusion. We would like the Board to clarify the applicability of this guidance to such programs as sales and purchase commitments, accounts receivable lines of credit and similar items arising in the normal course of business for commercial and industrial companies. We believe that it would be inappropriate to apply the proposed accounting for these types of programs. It is not clear whether the Board intended for the guidance to apply in these situations.

#### Skipped Question 3 due to limited applicability

Question 4: The proposed guidance would require an entity to not only determine if they have significant influence over the investee as described currently in Topic 323 on accounting for equity method investments and joint ventures but also to determine if the operations of the investee are related to the entity's consolidated business to qualify for the equity method of accounting. Do you agree with this proposed change to the criteria for equity method of accounting? If not, why?

We agree with the addition of the related criterion, as we believe it will result in fewer investments of a purely financial nature being accounted for with the equity method. However, we are concerned that the proposed guidance may be interpreted narrowly and/or that it may lead to diversity in practice. Currently, the guidance in paragraph 130 is not clear as to whether multiple factors are necessary or whether one relevant factor in some situations could be deemed sufficient to conclude that the investor and investee operations are related. When this uncertainty is coupled with the subjective nature of "significant influence" evaluations, we believe substantial diversity could result in practice. Perhaps it would be better to simplify the related criterion to focus on whether an investment is primarily financial in nature or whether strategic elements played an important role in the investment decision, at either the individual investment or the investment program level.

# Skipped Questions for Users 5 - 7

#### **Initial Measurement**

Questions for All Respondents

<u>Question 8</u>: Do you agree with the initial measurement principles for financial instruments? If not, why?

Yes, we agree with the use of fair value or transaction price as described in the proposed Update.

Question 9: For financial instruments for which qualifying changes in fair value are recognized in other comprehensive income, do you agree that a significant difference between the transaction price and the fair value on the transaction date should be recognized in net income if the significant difference relates to something other than fees or costs or because the market in which the transaction occurs is different from the market in which the reporting entity would transact? If not, why?

We agree with this principle. We also note that other asset and liability elements with determinable fair values should be identified and recognized in accordance with the proposed guidance.

Question 10: Do you believe that there should be a single initial measurement principle regardless of whether changes in fair value of a financial instrument are recognized in net income or other comprehensive income? If yes, should that principle require initial measurement at the transaction price or fair value? Why?

No. We believe that the transaction price is usually the most appropriate initial measurement principle when subsequent changes in fair value are not being recorded immediately in net income and that reliable evidence should exist before another initial measurement principle is justified.

Question 11: Do you agree that transaction fees and costs should be (1) expensed immediately for financial instruments measured at fair value with all changes in fair value recognized in net income and (2) deferred and amortized as an adjustment of the yield for financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income? If not, why?

Eligible fees and costs represent a component of all-in return on or cost of debt instrument transactions. We believe they should be deferred and amortized as an adjustment of the yield for debt instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income or at amortized cost.

Questions for Preparers and Auditors

Question 12: For financial instruments initially measured at the transaction price, do you believe that the proposed guidance is operational to determine whether there is a significant difference between the transaction price and fair value? If not, why?

Yes, we do believe that preparers will be able to operationalize this guidance. We appreciate that the guidance links significance to reliability, which is intuitive by analogy to how mathematical significance relates to variability. The implementation guidance may

want to expand on the reasoning behind this approach as a way to foster improved consistency in practice.

# **Subsequent Measurement**

Questions for All Respondents

Question 13: The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholders' equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?

We agree that many financial assets should be measured at fair value. We also agree with the exceptions noted in the proposed Update for certain financial assets, such as equity method investments. As explained in the main body of this letter, we disagree with certain provisions governing the recognition of changes in fair value. For example, the recognition method for many investments in equity securities would be through net income regardless of the business strategy for undertaking those investments. We strongly support a recognition model that contemplates both the entity's business model for managing the financial assets and the contractual cash flow characteristics of those assets.

We believe the measurement attribute for financial liabilities should accurately reflect what the liabilities are funding. Often, debt is issued by commercial and industrial companies for general corporate purposes and not for the purpose of acquiring financial assets. The assets used by these companies in their core operations are often accounted for at amortized cost and sometimes include substantial intangible assets that are not recognized under current accounting rules. The proposed Update restricts the use of "fair value through other comprehensive income" for certain types of issued debt (e.g. certain convertibles) and then further provides a fairly narrow, rules-based approach for qualifying for amortized cost treatment. These rules should be substantially revised to be more principles-based as we believe amortized cost is often the most relevant measurement attribute for issued debt. We are also concerned about the status of the "Financial Instruments with Characteristics of Equity" (FICE) project and its potential for interaction with the rules in the proposed Update. It would be costly to implement two different sets of convergence changes for instruments that could be affected by both the proposed Update and the FICE project. We therefore urge the Board to avoid making changes in the current project that could be subsequently affected by the FICE project.

Finally, we are concerned with the level of detail required by the proposed Update's presentation requirements. In our view, providing too much detail on the face of primary financial statements detracts from their usefulness. Also, we note that "fair value through other comprehensive income" treatment is elective so there will be cases where debt instruments are held for the collection of contractual cash flows but for which amortized cost presentation is not required (e.g. the preparer did not elect "fair value through other comprehensive income" even though they were permitted to do so). Therefore, we think it would be most useful to require an appropriately disaggregated <u>disclosure</u> of amortized cost

information for debt instruments held for contractual cash flows, regardless of whether or not "fair value through other comprehensive income" was elected.

Question 14: The proposed guidance would require that interest income or expense, credit impairments and reversals (for financial assets), and realized gains and losses be recognized in net income for financial instruments that meet the criteria for qualifying changes in fair value to be recognized in other comprehensive income. Do you believe that any other fair value changes should be recognized in net income for these financial instruments? If yes, which changes in fair value should be separately recognized in net income? Why?

We agree that the listed items should be recognized in net income, and that the remaining changes in fair value should be recognized in other comprehensive income. As explained in the main body of our letter, we do not believe that unrealized gains and losses should be recognized immediately in net income unless they result from a business strategy to actively trade instruments.

Question 15: Do you believe that the subsequent measurement principles should be the same for financial assets and financial liabilities? If not, why?

Speaking from the perspective of an industrial company, we believe reported net income has the best predictive value when subsequent measurement principles consider important factors such as business strategy, reliability and whether an instrument is held or issued. Said another way, our view is that having a single subsequent measurement principle for financial instruments would result in a suboptimal predictive value for net income and require greater reliance on footnote disclosure by users. We do not believe it would be appropriate to adopt a subsequent measurement principle for a particular type of financial instrument based on an assumption of improving financial reporting for financial statement users without carefully confirming, with a robust and unbiased methodology, that the assumption is true for a representative group of users and in full consideration of both financial and non-financial industries.

Question 16: The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?

We agree that reclassifications should not typically be required. However, we agree with the IASB's proposal that reclassifications should be allowed for financial instruments when an entity changes its business model for managing those instruments.

# Skipped Question 17 due to limited applicability

Question 18: Do you agree that a financial liability should be permitted to be measured at amortized cost if it meets the criteria for recognizing qualifying changes in fair value in other comprehensive income and if measuring the liability at fair value would create or exacerbate a measurement attribute mismatch? If not, why?

We believe amortized cost should often be preferred for the issued debt of commercial and industrial (C&I) companies. The currently proposed definition of "measurement attribute

mismatch" seems unnecessarily narrow and rules-based. We note that the magnitude of assets not accounted for at fair value is often significantly understated due to the recognition and measurement rules for such things as internally generated intangibles, as evidenced by the fact that many companies are valued at significant multiples to their recognized book values. Also, we observe that the magnitude of asset balances is but one of many relevant facts and circumstances that should be considered in associating issued debt with assets. Finally, we note that current interest capitalization rules tend to associate issued debt with assets that are out of scope for the financial instruments project. For these reasons, we support a principles-based approach for determining whether an attribute mismatch exists.

# Skipped Question 19 due to limited applicability

<u>Question 20</u>: Do you agree that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value with qualifying changes in fair value recognized in other comprehensive income in combination with other deferred tax assets of the entity (rather than segregated and analyzed separately)? If not, why?

We agree with this proposal as it will reduce diversity in deferred tax accounting for debt instruments with "fair value through other comprehensive income" treatment.

Question 21: The Proposed Implementation Guidance section of this proposed Update provides an example to illustrate the application of the subsequent measurement guidance to convertible debt (Example 10). The Board currently has a project on its technical agenda on financial instruments with characteristics of equity. That project will determine the classification for convertible debt from the issuer's perspective and whether convertible debt should continue to be classified as a liability in its entirety or whether the Board should require bifurcation into a liability component and an equity component. However, based on existing U.S. GAAP, the Board believes that convertible debt would not meet the criterion for a debt instrument under paragraph 21(a)(1) to qualify for changes in fair value to be recognized in other comprehensive income because the principal will not be returned to the creditor (investor) at maturity or other settlement. Do you agree with the Board's application of the proposed subsequent measurement guidance to convertible debt? If not, why?

We agree that this is the correct application of the principle in the proposed Update when the stated principal amount could be contractually settled with shares to some degree. However, we do not agree with this proposed principle. We believe amortized cost treatment will often provide the most meaningful reporting result for the liability component of issued convertible debt even when full or partial settlement in the issuer's own shares is possible.

#### Skipped Questions for Users 22 – 27

Questions for Preparers and Auditors

Question 28: Do you believe that the proposed criteria for recognizing qualifying changes in fair value in other comprehensive income are operational? If not, why?

Yes we think the criteria are operational. As noted in our response to question 13, we think the criteria for issued liabilities are presently too narrow.

We believe that "fair value through net income" is not the best method for dealing with non-marketable equity instruments that have not been acquired for trading purposes. The measurements for these instruments tend to be volatile and to involve many level 3 inputs. We have not seen any evidence to suggest that presenting these fluctuations in net income would improve its predictive capacity. In short, including these fluctuations in net income would certainly make the measure less reliable and would do so without any clear justification based on relevance.

Question 29: Do you believe that measuring financial liabilities at fair value is operational? If not, why?

Yes we believe the measurement itself will usually be operational but often not advisable as discussed in our response to question 13. One exception we could think of that might create significant operational challenges would be hybrid liabilities issued by private companies. We also note that significant operational issues beyond measurement exist. For example, the efforts that companies go through to prepare for meaningful discussions with investors and analysts will be much more complex if large, counterintuitive, non-operating fluctuations that are unrealized are recognized in net income. Furthermore, more of the limited time that is available for these discussions will necessarily be dedicated to explaining these items when many users might rather it be spent on more important topics relating to core operations.

Question 30: Do you believe that the proposed criteria are operational to qualify for measuring a financial liability at amortized cost? If not, why?

Yes they would be operational from our perspective. As noted in our response to question 18, we think the mismatch criteria should be principles-based and more broadly applicable. We also note that we think some preparers will face significant operational challenges with this guidance. For example, some preparers may have numerous debt issuances combined with a mix of assets that results in going back and forth between amortized cost and "fair value through other comprehensive income" treatment.

#### Skipped Question 31 due to limited applicability

### **Presentation**

Questions for All Respondents

Question 32: For financial liabilities measured at fair value with all changes in fair value recognized in net income, do you agree that separate presentation of changes in an entity's credit standing (excluding changes in the price of credit) is appropriate, or do you believe that it is more appropriate to recognize the changes in an entity's credit standing (with or without changes in the price of credit) in other comprehensive income, which would be consistent with the IASB's tentative decisions on financial liabilities measured at fair value under the fair value option? Why?

We believe changes in an entity's credit standing should not be reflected in net income. We do not know of any evidence that doing so would improve the predictive value of net income, and it seems counterintuitive to assume that an adverse change in an entity's credit standing should signal an improvement in future cash flows available for shareholders. Also, we are concerned that excessive disaggregation of reported components relating to financial instruments will detract from the usefulness of the primary financial statements of commercial and industrial companies.

Question 33: Appendix B describes two possible methods for determining the change in fair value of a financial liability attributable to a change in the entity's credit standing (excluding the changes in the price of credit). What are the strengths and weaknesses of each method? Would it be appropriate to use either method as long as it was done consistently, or would it be better to use Method 2 for all entities given that some entities are not rated? Alternatively, are there better methods for determining the change in fair value attributable to a change in the entity's credit standing, excluding the price of credit? If so, please explain why those methods would better measure that change.

Speaking from the perspective of an industrial company without significant leverage, we believe method 1 would be best due to its simplicity and low cost when credit ratings haven't changed. In terms of which methods should be allowed, we think the Board should make the principles and objectives clear and then present the methods as illustrations rather than as elections. We note that method 1 could be modified to account for the fact that some entities are not rated, so we do not believe that a lack of ratings should preclude something similar to method 1 as an option.

Question 34: The methods described in Appendix B for determining the change in fair value of a financial liability attributable to a change in an entity's credit standing (excluding the changes in the price of credit) assume that the entity would look to the cost of debt of other entities in its industry to estimate the change in credit standing, excluding the change in the price of credit. Is it appropriate to look to other entities within an entity's industry, or should some other index, such as all entities in the market of a similar size or all entities in the industry of a similar size, be used? If so, please explain why another index would better measure the change in the price of credit.

We think some preparers will find it difficult to analyze changes in the price of credit at the industry level. Various issues could arise, such as the lack of close comparables or the lack of recent trading data. Perhaps it would be appropriate to allow preparers to refer to higher level benchmarks (such as the average yield for all industrial or financial issuers with a particular rating) as a proxy for determining the changes in the price of credit.

Skipped Questions for Users 35 – 36

#### **Credit Impairment**

Questions for All Respondents

Question 37: Do you believe that the objective of the credit impairment model in this proposed Update is clear? If not, what objective would you propose and why?

We believe additional clarification of the objectives would be helpful. As explained in our responses to the following questions, there are several aspects of the proposed model that do not seem to us to result in reporting improvements.

Question 38: The proposed guidance would require an entity to recognize a credit impairment immediately in net income when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s).

The IASB Exposure Draft, Financial Instruments: Amortised Cost and Impairment (Exposure Draft on impairment), would require an entity to forecast credit losses upon acquisition and

allocate a portion of the initially expected credit losses to each reporting period as a reduction in interest income by using the effective interest rate method. Thus, initially expected credit losses would be recorded over the life of the financial asset as a reduction in interest income. If an entity revises its estimate of cash flows, the entity would adjust the carrying amount (amortized cost) of the financial asset and immediately recognize the amount of the adjustment in net income as an impairment gain or loss.

Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?

We believe it is inappropriate to recognize a credit loss in net income at the time of origination. Transaction prices should reflect investors' best estimates of the present values of credit losses as well as the present values of premiums to be paid by non-defaulting borrowers that are intended to cover credit losses, where present values are determined by discounting expected cash flows by investors' expected returns (and not contractual rates). Recognizing the present values of the credit losses up front, while recognizing the offsetting interest rate premiums over time, would result in understatements and overstatements of income over the life of any given vintage, which would detract from the predictive value of net income.

While we believe the IASB model is conceptually sound, we are concerned about its practicality. Decomposing a credit risk premium into its component parts to isolate expected credit losses requires subjective judgment and could lead to diversity in practice. For some portfolios and reporting entities, the cost of making these estimates may not be justified based on the potential significance of the reporting effects. We believe the guidance should allow for practical expedients when evidence suggests there have been no material changes in credit loss expectations.

Question 39: Do you agree that a credit impairment should not result from a decline in cash flows expected to be collected due to changes in foreign exchange rates, changes in expected prepayments, or changes in a variable interest rate? If not, why?

Yes, we agree with this principle.

Question 40: For a financial asset evaluated in a pool, the proposed guidance does not specify a particular methodology to be applied by individual entities for determining historical loss rates. Should a specific method be prescribed for determining historical loss rates? If yes, what specific method would you recommend and why?

We favor a clear articulation of the principles and objectives with some illustrative examples. We believe prescribed methods can result in reduced relevance because they constrain a preparer's ability to properly account for important facts and circumstances. For example, if a method based on historical loss rates experienced by a preparer were prescribed, the preparer may be forced to use information based on a small population of transactions or information that arose during unusual market conditions in estimating credit losses. This could easily result in overstatements or understatements.

Question 41: Do you agree that if an entity subsequently expects to collect more cash flows than originally expected to be collected for a purchased financial asset, the entity should

recognize no immediate gain in net income but should adjust the effective interest rate so that the additional cash flows are recognized as an increase in interest income over the remaining life of the financial asset? If not, why?

We do not agree with this principle because it seems to be based on conservatism. If the underlying principle is that credit related fluctuations should always be reflected in net income, then we believe both negative and positive credit-related changes should be recognized currently.

Question 42: If a financial asset that is evaluated for impairment on an individual basis has no indicators of being individually impaired, the proposed guidance would require an entity to determine whether assessing the financial asset together with other financial assets that have similar characteristics indicates that a credit impairment exists. The amount of the credit impairment, if any, would be measured by applying the historical loss rate (adjusted for existing economic factors and conditions) applicable to the group of similar financial assets to the individual financial asset. Do you agree with this requirement? If not, why?

Our concern with this is that it seems to suggest that a different principle is being applied for individual instruments vs. pools of instruments. If the expected loss of an individual instrument has already been recognized then it is not clear how its inclusion within a pool would change the overall expectation of loss.

#### Skipped Questions for Users 43 – 45

Questions for Preparers and Auditors

Question 46: The proposed guidance would require that in determining whether a credit impairment exists, an entity consider all available information relating to past events and existing conditions and their implications for the collectibility of the cash flows attributable to the financial asset(s) at the date of the financial statements. An entity would assume that the economic conditions existing at the end of the reporting period would remain unchanged for the remaining life of the financial asset(s) and would not forecast future events or economic conditions that did not exist at the reporting date. In contrast, the IASB Exposure Draft on Impairment proposes an expected loss approach and would require an entity to estimate credit losses on basis of probability-weighted possible outcomes.

Do you agree that an entity should assume that economic conditions existing at the reporting date would remain unchanged in determining whether a credit impairment exists, or do you believe that an expected loss approach that would include forecasting future events or economic conditions that did not exist at the end of the reporting period would be more appropriate? Are both methods operational? If not, why?

We believe any estimation of credit losses is highly subjective in nature and is based on a combination of past and present conditions and future expectations. In our view, the objective should simply be to estimate credit losses based on the preparer's best methodologies, information and assumptions at the reporting date. A principle that allows preparers to consider all of the information that market participants consider when estimating credit losses would provide users with better visibility to each preparer's ability to effectively incorporate all relevant assumptions into their credit loss predictions.

Question 47: The proposed guidance would require that an appropriate historical loss rate (adjusted for existing economic factors and conditions) be determined for each individual pool of similar financial assets. Historical loss rates would reflect cash flows that the entity

does not expect to collect over the life of the financial assets in the pool. Would such an approach result in a significant change in practice (that is, do historical loss rates typically reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool or some shorter period)?

We think the guidance should be more principles-based and that it should not prescribe specific methods. Making meaningful projections often requires a significant amount of historical data that many preparers will simply not have based on their own experience.

#### **Interest Income**

Questions for All Respondents

<u>Question 48</u>: The proposed guidance would require interest income to be calculated for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income by applying the effective interest rate to the amortized cost balance net of any allowance for credit losses. Do you believe that the recognition of interest income should be affected by the recognition or reversal of credit impairments? If not, why?

Yes, we agree that interest income should be calculated based on the amortized cost balance net of any allowance for credit losses. However, we believe that transaction prices contemplate the expectation of credit losses so that there should generally be no balance in the allowance at the time of origination or purchase. We agree with the IASB's conclusion that the rate used should be the original expected return and not the contractual return. Expected return is more appropriate in our view because this is the rate of return that market participants actually expect to achieve. Using this rate should thus maximize the predictive value of net income.

Question 49: Do you agree that the difference in the amount of interest contractually due that exceeds interest accrued on the basis of an entity's current estimate of cash flows expected to be collected for financial assets should be recognized as an increase to the allowance for credit losses? If not, why?

Yes. Conceptually, we think the allowance for credit losses has two offsetting components: 1) the present value of expected credit losses, plus 2) the present value of "default risk premiums" that are included in the contractual rate. Initially, these two factors offset each other such that the allowance account has no balance. Over time, the allowance may be positive or negative due to temporary timing differences in how credit losses arise and how default risk premiums are collected. We note that the investor will expect "good value" for any temporary cash flow deficits or surpluses associated with the allowance account (i.e. the balance in the account bears or incurs interest) when analyzing the investment opportunity. Therefore, we think the proper measure of interest income is based on the expected rate of return applied to the sum of the amortized cost and allowance account balances, as is the case with the IASB proposal.

Question 50: The proposed guidance would permit, but would not require, separate presentation of interest income on the statement of comprehensive income for financial assets measured at fair value with all changes in fair value recognized in net income. If an entity chooses to present separately interest income for those financial assets, the proposed guidance does not specify a particular method for determining the amount of interest income to be recognized on the face of the statement of comprehensive income. Do you

believe that the interest income recognition guidance should be the same for all financial assets?

We believe the guidance should provide for some flexibility. Preparers may use the "fair value through net income" category for different reasons, and it will sometimes be appropriate to present interest income differently under different circumstances. For example, preparers may conclude that it is best to present interest income differently for instruments that are traded vs. instruments that are being held for contractual cash flows but that are being marked through net income.

Question 51: Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient to understand the proposed credit impairment and interest income models? If not, what additional guidance or examples are needed?

If the currently proposed model is retained, we think it will be important to clarify the distinction (if any) between estimating credit losses for individual instruments vs. estimating those losses for pools.

Skipped Questions for Users 52 - 55

# **Hedge Accounting**

Questions for All Respondents

Question 56: Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

Yes we agree with this change as we think hedges that are economically effective over their life sometimes fail to be "highly effective" at specific points in time.

Question 57: Should no effectiveness evaluation be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term? Why or why not?

Due to changing market conditions, we think it is possible for subsequent expectations about effectiveness to differ from initial expectations. Therefore, we believe it makes sense to require at least a qualitative effectiveness evaluation when conditions suggest that a reevaluation is needed.

Question 58: Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? Why or why not?

Yes, as historically the standard has been "highly effective" which would tend to result in more disqualifications than "reasonably effective" would.

We would also suggest that the guidance should illustrate a reasonable approach when fair value fluctuations are dominated by "noise." For example, if the underlying has not changed much it is sometimes the case that both the hedging instrument and the hedged item have experienced small absolute changes in value but significantly different relative

changes in value, so that when the ratio of the changes is computed a large (but meaningless) number results. Some have taken a "hard line" view that disqualification should result. We think such a view is inconsistent with the objectives of effectiveness evaluation and that this is especially so under a "reasonably effective" standard.

# Skipped Questions for Users 59 - 60

Questions for Preparers and Auditors

Question 61: Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for cash flow hedging relationships? If yes, what constraints do you foresee and how would you alleviate them?

We appreciate the Board's efforts to relieve some of the unnecessary burden of calculating ineffectiveness in the presence of minor timing differences. We believe the remaining requirements could be further improved for simple hedges that do not involve significant "basis risks." For example, this would include shorter-term foreign currency hedges implemented with simple forward contracts.

Question 62: Do you foresee any significant operational concerns or constraints in creating processes that will determine when changes in circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness at each reporting period? If yes, what constraints do you foresee and how would you alleviate them?

We do not see any significant operational concerns but it does tend to take a significant amount of time, cost and effort to implement the changes in systems and processes. These processes and systems are complex and changing them involves carefully coordinating coding changes and testing with changes of front- and back-office processes and extensive training of decentralized personnel. Allowing more time for these changes will help preparers minimize the cost.

Question 63: Do you foresee any significant operational concerns or constraints arising from the inability to discontinue fair value hedge accounting or cash flow hedge accounting by simply dedesignating the hedging relationship? If yes, what constraints do you foresee and how would you alleviate them?

Yes, as explained in the main body of this letter we do have concerns with this guidance. We recommend that the Board remove the restrictions rather than increasing both the operational and cost burdens.

Question 64: Do you foresee any significant operational concerns or constraints arising from the required concurrent documentation of the effective termination of a hedging derivative attributable to the entity's entering into an offsetting derivative instrument? If yes, what constraints do you foresee and how would you alleviate them?

Assuming no change in hedging strategy, the proposed guidance will likely require an increase in the volume of derivative transactions with a corresponding increase in documentation and other transactional support activities. We are concerned about the need to support these added documentation and transactional burdens as they will increase the costs of hedging activities. Also, we note that there may be operational issues with transacting the new derivative contracts as these contracts sometimes require lead time to

transact and it may not always be possible to initiate a new contract on the same day a hedge relationship ends.

### **Disclosures**

Questions for All Respondents

Question 65: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement do you believe should not be required and why?

Overall, we agree with the disclosure requirements that are applicable to us. We appreciate the Board's explicit acknowledgement in paragraph IG171 that disclosures should strike an appropriate balance between disaggregation and clarity. As noted previously, we believe there should be less disaggregated presentation on the face of the primary financial statements for commercial and industrial preparers. As noted in our response to question 13, we believe it would be useful to disclose amortized cost information for debt instruments held for contractual cash flows, regardless of whether or not "fair value through other comprehensive income" was elected.

Skipped Questions for Users 66 – 67

#### **Effective Date and Transition**

Questions for All Respondents

Question 68: Do you agree with the transition provision in this proposed Update? If not, why?

Yes, we agree with cumulative effect transition as currently proposed.

Skipped Question 69 due to limited applicability

Questions for Preparers and Auditors

Question 70: How much time do you believe is needed to implement the proposed guidance?

Due to the comprehensive scope of the proposed Update, we will need to make significant changes to several investment and accounting systems and to numerous spreadsheets, databases, key controls, accounting policies and disclosure processes. These changes will need to be identified, designed, tested, documented and implemented. In addition, hundreds of employees worldwide will need to be thoroughly trained on new rules and new procedures. Due to the magnitude of this project, we believe it will take a minimum of 2-3 years from the date of issuance to implement the necessary changes.

<u>Question 71</u>: Do you believe the proposed transition provision is operational? If not, why?

Yes, we believe cumulative effect transition will be operational.