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

Dear Ms. Cosper:

Re: Proposed Accounting Standards Update: Financial Instruments – Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities

The Canadian Bankers Association¹ (CBA) would like to thank the Financial Accounting Standards Board (the "FASB" or the "Board") for its work to date with respect to Proposed Accounting Standards Update: Financial Instruments – Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities (the "FASB ED").

We believe that the ED is a positive step in achieving the goal of simplifying the accounting for financial instruments through the issuance of a standard that is less complex. However, in order to achieve the Board's objective more effectively, we believe that certain changes are needed in the FASB ED.

Comments related to IFRS and U.S. GAAP convergence

We believe that the FASB ED is a positive step in the convergence of IFRS and U.S. GAAP and we acknowledge and appreciate the Board's considerable efforts in working with the International Accounting Standards Board ("IASB") in this respect. We are encouraged that the most recent IFRS 9: *Financial Instruments* ("IFRS 9") proposals have introduced a fair value through other comprehensive income ("FV-OCI") classification for qualifying debt instruments in a manner similar to the FASB ED and are appreciative that both the FASB and the IASB are working towards convergence on this point.

¹ The Canadian Bankers Association works on behalf of 55 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness.

We encourage further convergence on key points relating to classification and measurement to ensure comparability between international banks and their U.S. counterparts, and have raised a number of points related to this objective in our responses to the questions set out in the FASB ED (see Appendix A). Some of the areas in which we believe that it would be appropriate for the FASB to align with IFRS 9 include:

- The ability to designate loan commitments under the fair value through net income ("FV-NI") classification through the fair value option ("FVO") to allow banks to minimize accounting mismatches associated with the economic hedging of the interest rate risk of loan commitments with derivatives required to be carried at FV-NI (see questions #1 and #13).
- The application of foreign exchange translation to foreign denominated financial assets
 classified as FV-OCI in a manner that results in the same net income that would have
 occurred had the same foreign denominated financial asset been classified as Amortized
 Cost. This will minimize accounting mismatches in net income when the foreign exchange
 risk of a foreign denominated asset classified as FV-OCI is economically hedged by foreign
 denominated liabilities classified as Amortized Cost (see question #26).
- The restrictive definition of "principal" (see question #5) in the cash flow characteristics test to avoid a broadening of the FV-NI category beyond the likely intent of the Board.
- The determination of the reclassification date upon the change in a business model (see question #22).

While we believe that there are certain areas in which an IFRS / U.S. GAAP difference is created between the two exposure drafts, we support the principles under the FASB proposals for some of these areas, including:

- The requirement to measure non-recourse liabilities that are settled with only cash flows from the related financial assets on the same basis as those assets (see question #17).
- The requirement to 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 separately from other deferred tax assets (see question #20).
- The ability to apply a practicality exception to equities without readily determinable fair values (see question #19).
- The ability to recycle realized "own credit" gains and losses into net income upon settlement of liabilities (see question #30).

We believe that these points should be considered in the FASB's and IASB's continued discussions concerning convergence.

Comments related to areas of concern common to both the FASB ED and the IFRS 9 proposals

We have also raised a number of concerns related to areas of the FASB ED that are converged with IFRS that we believe should be considered by both the FASB and the IASB with the objective of ensuring accounting standards are of the highest quality and operate in a manner that reflects the economics of our businesses. We raised similar concerns on some of the following points in our recent letter to the IASB dated March 28, 2013 in respect of Exposure Draft ED/2012/4 Classification and Measurement: Limited Amendments to IFRS 9 (Proposed amendments to IFRS 9 (2010)):

- The need to introduce an "insignificantly different" exception to the cash flow characteristics test so that the elimination of bifurcation accounting for financial assets will not cause insignificant embedded derivatives to result in full FV-NI accounting for the entire instrument in contrast to the underlying business model (see questions #6 and #21).
- Our belief that "special features" that result in interest being determined in direct reference to
 the amount of funds borrowed in an unlevered manner (e.g., interest rate mismatch features)
 should be considered to be solely in respect of principal and interest without the detailed
 assessment suggested in the "modified economic relationship" guidance (see question #7).
- To the extent the "modified economic relationship" guidance is retained, the need for increased clarity around the interpretation of the underlying concepts to promote consistency of practice (see questions #7 and #8).
- The introduction of a practical expedient to the look-though approach that requires an entity to evaluate senior beneficial interests that are of a certain credit quality (e.g. rated AA or higher) under the cash flow characteristics test at the beneficial interest level, instead of looking through to the individual assets in the underlying pool (see question #9).
- The need for greater clarity on the ability to sell financial assets in response to credit risk related concerns in the context of the Amortized Cost category to allow banks to proactively manage this risk (see questions #10 and #11).

Although the FASB ED is not solely intended for financial institutions, the primary driver is to make amendments to GAAP in response to the financial crisis. Consequently, these concerns are of particular importance to the banking industry. We are also particularly concerned about the relationship between the classification and measurement of financial instruments and the Basel III capital requirements, especially when differences in the accounting classifications will result in differences in required regulatory capital. For example, while we favor the continuation of the FV-OCI classification for qualifying fixed income assets, we believe that many securities that would be best represented in Amortized Cost will instead be required to be classified as FV-OCI by both the FASB-ED and the IFRS 9 proposals even though this will cause an accounting mismatch with the Amortized Cost liabilities that the securities support. This accounting mismatch could in turn cause significant capital volatility under Basel III.

Lastly, if you have any questions concerning our key messages in this letter and/or specific comments or suggestions on our responses to the Board's questions in Appendix A, the Chief Accountants of the Canadian banks would be pleased to discuss them.

Sincerely,

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Attachment: Appendix A

Appendix A

Questions for Preparers

Question 1: Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments should be included or excluded from the guidance in this proposed Update and why?

We agree with the scope of financial instruments included in the FASB ED, except that
we believe that the scope exception in paragraph 825-10-15-8(i) should be modified to
allow loan commitments to be designated as FV-NI via the fair value option. This
expansion of the scope would better align the FASB ED with IFRS 9 and allow banks to
minimize accounting mismatches associated with the economic hedging of the interest
rate risk of loan commitments with derivatives required to be carried at FV-NI (see
question #13 below).

Question 2: Do you agree with the industry-specific specialized guidance scope exceptions in paragraph 825-10-15-9? If not, why? What would you propose instead?

We have no comment on this question.

Question 4: Do the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment? If not, why? What would you propose instead?

- We agree that the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment. However, we do have a number of concerns with:
 - o the definition of principal (see question #5 below);
 - the "modified economic relationships" guidance within the contractual cash flow characteristics assessment (see questions #6, #7 and #8 below); and
 - the elimination of the ability to bifurcate embedded derivatives in a financial asset (especially when the embedded derivative is insignificant) which then would cause the entire financial asset to be classified as FV-NI pursuant to the application of the contractual cash flow characteristics assessment (see questions #6 and #21 below).

Question 5: The proposed amendments define principal as the amount transferred by the holder at initial recognition. Should the definition of principal be expanded to include repayment of the principal amount at maturity or other settlement? If so, what instruments would fail (or pass) the contractual cash flow characteristics criterion as a result of this change?

- We believe that the definition of principal should be amended to refer to the principal amount due under the contract. Otherwise, prepayable debt securities or loans purchased at a discount that would otherwise clearly meet the SPPI test and which are held in a portfolio that would meet the business model test for either Amortized Cost or FV-OCI may instead be required to be classified as FV-NI in contrast to the underlying business model. This concern is based on the potential interpretation that the lender could earn a return that is significantly higher than the return would be for the time value of money and the credit risk on the principal outstanding.
- We also believe that the manner in which "principal" is currently defined in the FASB ED will cause a difference in practice with IFRS 9. While "principal" is not explicitly defined in IRFS 9, we believe that most preparers would define "principal" in a manner consistent

with our suggestion above. As a result, an alternative to the suggestion above to redefine "principal" in the FASB ED would be to utilize the principles found in IFRS 9.

Question 6: Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?

- We believe that the usefulness and clarity of the contractual cash flow characteristics test
 would be enhanced if guidance was provided that more fully explains some of the
 supporting concepts used, particularly in regards to the "modified economic relationships"
 guidance discussed in our responses to questions #7 and #8 below.
- In the absence of such clarifying guidance and based on our discussions with other
 global financial institutions and banking associations, we are concerned that inconsistent
 application would result in practice. This may also lead to conclusions that are not
 congruent with our understanding of the intended principles of the contractual cash flow
 characteristics test (see question #7 below), and different conclusions across different
 entities could result for similar or even identical instruments.
- We also believe that the "insignificantly different" exception should be expanded to all special features meant to be assessed using the cash flow characteristics test, and not just those within the confines of the "modified economic relationships" guidance. Otherwise, the cash flow characteristics test will result in the use of FV-NI accounting for the entire financial asset, which will not be in alignment with the business model for such a financial asset (see questions #7 and #21 below).

Question 7: Should a financial asset with a contractual term that modifies the economic relationship (see paragraphs 825-10-55-17 through 55-20) between principal and interest be considered to contain cash flows that are solely payments of principal and interest? Should this be the case if, and only if, the contractual cash flows could or could not be more than insignificantly different from the benchmark cash flows as discussed in paragraph 825-10-55-19? If not, why? What would you propose instead?

- We believe that instruments should be accounted for at Amortized Cost if the business intent is to collect contractual cash flows as compensation for the lending of funds. As a result, we agree that a financial asset with a modified economic relationship between principal and interest could be considered, for the purposes of the ED, to contain cash flows that are solely payments of principal and interest.
- In principle, we believe that "special features" such as interest rate mismatch features that result in interest being determined in direct reference to the amount of funds borrowed in an unlevered manner should be considered to be solely in respect of principal and interest without a detailed assessment. As a result, we do not believe that it is relevant whether the contractual cash flows could be more than insignificantly different from the benchmark cash flows.
- In fact, we believe that the contractual cash flow test should not be tainted by a special
 feature that would not at the instrument's inception be anticipated to cause a gain or noncredit related loss at maturity of the financial asset that would otherwise be avoided by
 accounting for the whole instrument at fair value during the life of a financial asset.
- In contrast, we believe that special features that should cause an instrument to not solely
 be in respect of principal and interest can usually be qualitatively identified. For example,
 equity or commodity linked features, including equity conversion features, in which a gain
 or non-credit related loss at maturity can be reasonably anticipated at the instrument's
 inception. However, in the absence of bifurcation accounting (see question #21 below),
 we believe that even these types of special features should be considered solely principal

and interest for the purpose of the cash flow characteristics test to the extent they are considered insignificant to the instrument at inception.

Question 8: Do the proposed amendments contain sufficient application guidance in paragraphs 825-10-55-17 through 55-20 on assessing a modified economic relationship? If not, why?

- In the absence of clarifying illustrations and examples, we believe that the "modified economic relationships" guidance within the contractual cash flows assessment creates new complexity in the determination of the classification of financial assets which is inconsistent with the objectives of reducing complexity and improving comparability.
- We do not believe that assets with interest rate mismatch features should be measured at FV-NI if the feature is not levered and will not otherwise cause a gain or loss upon settlement (see question #7 above). That being said, if the intent of the Board is to require a detailed assessment, we believe that illustrative examples should be provided of when the features both cause a pass and a fail of the cash flow characteristics test. Otherwise, we believe that diversity in practice amongst preparers will develop based on our discussions with other global financial institutions and banking associations.
- We also believe that detailed supporting guidance and illustrations should clearly articulate the meaning of "more than insignificantly different than the benchmark cash flows" and in particular:
 - o the determination of the "benchmark" cash flows:
 - the meaning of "insignificantly different" or preferably the replacement of "insignificantly different" with "anticipated to be insignificant at inception". This is in alignment with the recommendations in our responses to questions #7 and #21 to prevent an insignificant embedded derivative from causing the entire instrument to be classified as FV-NI; and
 - the construction of the hypothetical asset particularly in markets with limited market observable inputs.
- In addition, we believe that application guidance or information in the Basis for Conclusions would be helpful to articulate the intended differences between the proposed "modified economic relationship" test and the "closely related" guidance in existing U.S. GAAP.

Question 9: For beneficial interests in securitized financial assets, the proposed amendments would require an entity to look through to the underlying pool of instruments in determining whether the tranche contains payments of solely principal and interest. Do you agree with this look-through approach? If not, why? What would you propose instead?

- While we appreciate that the look-through approach is aligned with the IFRS 9 proposals, we do not agree with the approach. Since in many cases it will not be operable to look through to the individual assets collateralizing a securitized beneficial interest, we recommend that a practical expedient be incorporated. Our suggestion would be for an entity to evaluate senior beneficial interests that are of a certain credit quality (e.g., rated AA or higher) using the cash flow characteristics test at the beneficial interest level, rather than looking through to the individual assets in the underlying pool.
- We believe that the proposed look-through approach should only be applied to those lower quality secured beneficial interests (e.g., those that are rated less than AA) that do not qualify for the practical expedient and that if the entity is not able to conduct the test for operability reasons, the beneficial interest should be measured at FV-NI.

Question 10: Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?

- We believe that the proposed amendments appropriately convey the principle associated with the business model assessment. However, as discussed below in our response to this question we believe that it would have been more appropriate for both the FASB and IASB proposals to have expanded the definition of the business model to take into account the manner in which liabilities supported by the assets are accounted for in order to avoid inappropriate accounting mismatches. In addition, we have some concerns as to the dividing line between Amortized Cost and FV-OCI as discussed in our response to question #11 below.
- We appreciate that the FASB ED continues to include a FV-OCI category and are pleased that the recently proposed IFRS 9 limited amendments will, if accepted, converge with U.S. GAAP on this point. We believe that this category will encompass many of the liquidity and interest rate management portfolios that are common in the Banking industry. With banks around the world under increasing scrutiny from regulators to robustly manage their liquidity needs, while also managing their interest rate risk positions, it is crucial that the final accounting standard facilitates the banks' ability to properly reflect the substance of these activities in their financial reporting.
- The absence of a FV-OCI category under IFRS 9 would result in (i) a material IFRS vs.
 U.S. GAAP difference; and (ii) significant net income volatility under IFRS relative to both
 U.S. GAAP and the underlying economics; for many of our liquidity and interest rate
 management portfolios. This is based on our understanding that both the IASB and
 FASB believe that the Amortized Cost category should not be used for these portfolios to
 the extent the sales activity necessary to rebalance the portfolios may be more than
 insignificant or infrequent.
- We support the FV-OCI category under both U.S. GAAP and IFRS because we believe the other comprehensive income ("OCI") /equity volatility that would result is preferable to the net income volatility that may have otherwise resulted from the use of the FV-NI category. However, we believe that the OCI/equity volatility is still not the best representation of the business model of a bank, particularly for portfolios of securities that are held and managed to support liabilities such as deposits and debentures (either from an interest rate management or liquidity perspective) that are accounted for at Amortized Cost (i.e., unwarranted OCI accounting mismatch occurs because there is no OCI from the liabilities to offset the OCI from the securities). We also believe that similar considerations apply to banks that wish to economically hedge interest rate risk associated with fixed rate preferred shares classified as equity in an efficient manner through the use of high quality debt securities.
- While we believe that the definition of the business model under both the FASB and IASB proposals should have taken into account the manner in which liabilities supported by the assets are accounted for, we appreciate and accept the FASB's and the IASB's view that the Amortized Cost category should only include financial assets that are aligned with the management business model of collecting principal and interest.

Question 11: Do the proposed amendments provide sufficient application guidance and illustrations on how to distinguish among the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the proposed guidance provided to describe those business models? If not, why?

• We believe that the ED generally provides sufficient application guidance.

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- However, we believe that amendments would be beneficial in relation to the dividing line between Amortized Cost and FV-OCI involving the ability to sell assets in response to credit deterioration without disallowing the Amortized Cost classification.
- We note that the ED indicates in paragraph 825-10-55-31 that sales that are the result of the deterioration in the asset's credit quality are not inconsistent with the objective of hold to collect.
- To clarify the distinction between Amortized Cost and FV-OCI, we believe that it should be indicated in both the FASB ED and IFRS 9 that even more than infrequent or insignificant sales should not preclude Amortized Cost accounting provided that either:
 - the sales are a result of management's changing view on the credit quality of the assets even if the change in credit quality is not externally observable; and there is objective and supportable internal evidence indicating that management believes the credit quality has deteriorated; or
 - a regulator requires the entity to sell the financial asset based on the regulator's view of the credit risk.
- We believe that this is important in order to not limit management's ability to actively and prudently manage the credit risk inherent in the bank's various securities portfolios that would otherwise qualify for Amortized Cost. Only allowing sales to occur after credit quality deterioration becomes externally observable (in order to qualify for the Amortized Cost treatment) is generally too late in most cases. In addition as an anti-abuse measure, management should have a clearly documented credit risk management strategy to support the different triggers that may result in sales and such triggers should be directly related to the management of credit risks.

Question 12: Should the classification and measurement model for financial instruments contain an explicit tainting notion or should it rely on the principle and exercise of professional judgment? Why?

- We do not believe that the classification and measurement model for financial instruments should contain an explicit tainting notion.
- The introduction of a tainting notion that has the effect of precluding the use of an accounting category in the future based on prior variances only serves to cause inappropriate accounting in the future that will not align with the current business model.

Question 13: The proposed amendments would require loan commitments, a revolving line of credit, or a commercial letter of credit (the potential creditor) to be measured on the basis of the likelihood of exercise of the commitment and the classification of the underlying loan that would be made upon exercise of the commitment. Do you agree with the proposed classification of loan commitments? If not, why? What would you propose instead?

• We agree with the proposed amendments as the default accounting for loan commitments, except that we believe that entities should be able to elect to apply the fair value option to a loan commitment if its interest rate risk is economically hedged by financial instruments that are carried at FV-NI (see question #1 above). Otherwise, banks may experience accounting mismatches that do not represent the underlying economics of their businesses. In particular, this would be the case for loan commitments for loans that the bank will account for at Amortized Cost in which the loan commitment allows the bank's counterparty to draw the loan at a fixed rate that is set at the beginning of the commitment period.

Question 14: Do you agree with the initial measurement principles for financial instruments? If not, why?

- We agree with the initial measurement principles for financial instruments and understand that the principles are converged with those in IFRS 9.
- However, we note that the FASB ED requires financial instruments not subsequently measured at FV-NI to be measured at the transaction price on initial recognition, while IFRS 9 requires a financial instrument not subsequently measured at FV-NI to be initially measured at its fair value plus or minus transaction costs that are directly attributable to the acquisition or issue of the financial instrument. While we believe that there is no practical difference after considering the basis of conclusion in the FASB ED, it would be beneficial for both the FASB and the IASB (collectively, the "Boards") to adopt standardized language in this area to avoid any potential interpretation differences that the Boards might not intend.

Question 16: Should financial liabilities subsequently be measured at amortized cost, unless certain exceptions are met? If not, why?

- We agree that financial liabilities should subsequently be measured at Amortized Cost, unless certain exceptions are met (e.g., securities sold short), because Amortized Cost generally provides the most useful information as liabilities are in most cases managed on a hold to pay basis.
- For those liabilities that are managed on a fair value basis (which generally would be in conjunction with derivatives and financial assets with offsetting market risks), the reporting entity would likely elect the fair value option to maximize the alignment of the economics and the accounting.

Question 17: The proposed amendments would require a nonrecourse financial liability that is settled with only the cash flows from the related financial assets (see paragraph 825-10-35-11) to be measured on the same basis as those assets. Do you agree with the proposed amendments? If not, why? What would you propose instead?

• We agree that the FASB proposal would minimize accounting mismatches and therefore result in accounting that is more consistent with the underlying economics, although we note that this requirement represents a difference with the proposals in IFRS 9. It appears that this GAAP difference would most likely appear when the related financial asset is accounted for in the FV-OCI category as IFRS does not have an offsetting OCI category for financial liabilities (except as is proposed for the insurance accounting model). We believe that this point should be considered in the FASB's and IASB's continued discussions concerning convergence.

Question 18: The proposed amendments would require financial assets measured at amortized cost that are subsequently identified for sale to continue to be classified and measured at amortized cost less impairment and would prohibit recognition of the gain, until the sale is complete. Do you agree with the proposed classification and measurement requirements? If not, why?

 We agree with the proposed classification and measurement requirements. Otherwise, the comparability of the recognition of gains between entities might be reduced as a result of the inherent difficulties in uniformly defining a recognition trigger based on a subjective measure such as "the identification of assets for sale". In addition, such a trigger might be considered by users to be somewhat arbitrary.

- Also, the proposed classification and measurement requirement in this area aligns with the IASB proposals.
- However, we believe that it should be clarified that the ability or intent to sell a financial
 asset classified as Amortized Cost should not limit an entity's ability to adjust impairment
 provisions either upwards or downwards (not to exceed the amortized cost amount) so
 that the provisions reflect management's most up-to-date view concerning expected
 credit losses.

Question 19: The proposed amendments would provide a practicability exception for measuring equity investments without readily determinable fair values that do not qualify for the practical expedient in paragraph 820-10-35-59 (that is, the net asset value per share expedient) and a one-step impairment model for all equity investments subject to the practicability exception. Do you agree with the proposed amendments? If not, why?

- We agree that the practical exemption for measuring equity investments without readily determinable fair values that do not qualify for the practical expedient in paragraph 820-10-35-59 is preferable to classification in FV-NI. This practical exemption will reduce "artificial" net income volatility that would otherwise result from the high degree of subjectivity inherent in calculating fair values for illiquid equity investments. Such volatility is not consistent with the longer term investment horizons often associated with equity investments with fair values that are not readily determinable.
- While we note that this practical exception may cause a lack of comparability between entities that report under U.S. GAAP from those that report under IFRS as the latter does not include the same practical exception, we believe the FASB approach is more appropriate for the reasons noted above. While IFRS 9 paragraphs B5.4.14 and .15 contain the limited ability to presume that cost equals fair value, the limited exceptions would not apply to a typical private equity investment in which a reasonable (but still very subjective) range of fair values could still be determined. Under the FASB ED, a typical private equity would instead appear by definition to not have a Readily Determinable Fair Value and would therefore qualify for the practical exemption.
- While we note that IFRS 9 contains an election to classify equities that are not held for trading in an irrevocable FV-OCI category that would alleviate the concern of increased net income volatility under IFRS relative to U.S. GAAP, we believe that this category should not have been introduced by the IASB and support the fact that the category was not proposed by the FASB. We do not believe that such a category better reflects the economics of investing in private equities relative to either existing IAS 39 or to existing U.S. GAAP because of the inability to recycle realized gains and losses from OCI into net income. We believe that this point should be considered in the FASB's and IASB's continued discussions concerning convergence.

Question 20: Should an entity 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 separately from the other deferred tax assets of the entity (rather than combined and analyzed together)? If not, why?

While we note that this requirement causes a U.S. GAAP / IFRS difference, we agree that
it better aligns with the "backward tracing" requirements to present changes in the value
of deferred taxes in OCI for deferred tax balances that arose from temporary differences
on items that are reported in OCI. We believe that this point should be considered in the
FASB's and IASB's continued discussions concerning convergence.

Question 21: Under the amendments in this proposed Update, hybrid financial assets would not be required to be analyzed for bifurcation under Subtopic 815-15 and would be assessed in their entirety on the basis of the proposed classification requirements. In contrast, hybrid financial liabilities would be assessed for bifurcation and separate accounting under Subtopic 815-15, and the financial liability host contract would be subject to the proposed amendments. Do you agree with this proposal? If not, why? What would you propose instead?

- We agree that bifurcation accounting should continue to be permitted for financial liabilities under U.S. GAAP and note that this is consistent with the IFRS 9 proposals.
- We also understand and appreciate that the bifurcation requirements were eliminated for financial assets consistent with the objective of simplifying the accounting, which is an objective that we endorse. While we also note that this change is also consistent with IFRS 9, we believe that both IFRS and U.S. GAAP should either allow bifurcation accounting to be continued for insignificant embedded derivatives or alternatively IFRS and U.S. GAAP should not require the entire financial asset to be classified as FV-NI if:
 - the "special feature" would only be expected to be significant under remote future circumstances; and
 - o Amortized Cost or FV-OCI is not consistent with the underlying business model.
- Consistent with the above and in the context of the existing proposals concerning the
 cash flow characteristics test, this may require the expansion of the "insignificantly
 different" exception to all special features, not just those within the confines of the
 "modified economic relationships" guidance (see questions #4, #6 and #7 above).
 Otherwise, the cash flow characteristics test will result in many instances of FV-NI
 accounting that are not in alignment with the business model and that are contrary to
 results from the application of the embedded derivative bifurcation guidance under
 existing U.S. GAAP.
- An example illustrating the need for this amendment can be found when considering the accounting for holders of non-viability-contingent-capital ("NVCC") instruments, which are becoming an increasingly common source of funding and capital in the financial services sector as a result of regulatory initiatives. NVCC instruments are priced and are expected to behave in a manner similar to long term debt, but are afforded capital treatment by regulators as they generally require that the instrument be converted into common shares at a price that will be punitive to the holder in the contingent event that the financial institution is deemed "not viable" by its regulator. The rationale for this type of special feature is to ensure that the providers of funding under these instruments suffer an economic consequence (similar to the common shareholders) in the unlikely event that the institution's national government is put in a position to have to provide economic support. In addition, these instruments typically also require interest to be deferred in the contingent event that the institution is not deemed solvent by its regulator. The trigger event of "non-viability" to convert is deemed extremely remote and therefore is not of significance from an economic perspective.
- While the holders of such instruments might consider the conversion feature to be an embedded derivative under existing U.S. GAAP and IFRS, the mark-to-market would be insignificant over the instrument's life to the extent that the "non-viability" triggering event to convert continued to be considered extremely remote. However, if it was interpreted that the contractual cash flow characteristics test would not be met either as a result of (i) the possibility at inception that the conversion could potentially one day be significant (even though this event is not expected) or (ii) the potential for the deferral of interest in similarly unlikely circumstances; then the holders of such instruments would be exposed to mark-to-market volatility for changes in interest rates throughout the life of the

instrument (not associated with the conversion feature). This would be the case even though the change in fair value from changes in the degree that the conversion feature or interest deferral was out-of-the money was insignificant from period to period. We do not believe this should be the intended accounting under the FASB ED. Absent a revision to include an "insignificantly different" exception as described above, it could discourage some holders from investing in these types of instruments, and in turn increase the cost of capital of the institutions issuing these instruments, as the holders generally invest in these instruments in order to earn yield by collecting the contractual cash flows over the instrument's life.

Question 22: The proposed amendments would require reclassification of financial assets when a change in business model occurs and prescribes how those changes should be subsequently accounted for. Do you agree with the proposed amendment on reclassifications? If not, why?

- We agree with the proposed amendments concerning when reclassification is required (i.e., when a change in business model occurs) and we also agree that this should be rare
- However, we would have preferred that the IASB and FASB had come to an agreement on the definition of the reclassification date. The FASB ED indicates that the reclassification date should be the last day of the reporting period in which an entity's business model changes, while IFRS 9 considers the reclassification date to be the first day of the first reporting period following the change in business model. We believe that the two standards should converge by employing the same definition of the reclassification date in order to avoid undue complexity for U.S. subsidiaries of foreign banks and to promote comparability between U.S. banks and their international peers. This could be particularly important in the rare, but significant, event that a number of banks around the world were to simultaneously reclassify their financial assets in response to a significant change in the macroeconomic environment.

Question 26: The proposed amendments would require an entity to separately recognize in net income changes in fair value attributable to foreign currency gain or loss on foreign-currency-denominated debt securities measured at fair value through other comprehensive income (see paragraphs 825-10-45-14 through 45-15). Is the proposed fair-value-based method provided for computing the foreign currency gain or loss component operable? If not, why? What would you propose instead?

- While we believe that the proposed fair-value-based method provided for computing the
 foreign currency gain or loss is operable, we do not believe that it is appropriate. In
 particular, the recognition of foreign exchange translation on the difference between the
 foreign denominated fair value and foreign denominated amortized cost in net income
 rather than OCI causes:
 - o a U.S. GAAP to IFRS difference;
 - an accounting mismatch in net income when the foreign exchange risk of a foreign denominated asset classified as FV-OCI is economically hedged by a foreign denominated liability classified as Amortized Cost; and
 - o incomparable net income for identical foreign denominated financial assets classified as Amortized Cost from those classified as FV-OCI.

Question 29: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement would you change and why?

- We believe that FASB should consider aligning the proposed disclosures related to Core
 Deposit Liabilities with the disclosure guidelines related to liquidity risk (as they pertain to
 deposits) issued by the Enhanced Disclosure Task Force ("EDTF") to ensure greater
 comparability between U.S. and international banks.
- We also believe that the requirement to disclose the All-in-cost-to-service Rate is not operable. In particular, the inclusion of "the expense of maintaining a branch network" in the rate requires an excessive amount of judgment to determine and may also result in banks disclosing sensitive information concerning their cost structures that may be considered proprietary to the effective execution of their distribution strategies. In addition, comparability may suffer as the manner of determining the rate may not be consistent across banks as cost allocation methodologies are not standardized, especially across banks with different mixes of retail and wholesale operations and with different mixes of the types of products offered at the branches in their retail operations.

Question 30: Should an entity be permitted to early adopt only the proposed presentation requirements related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the fair value option under the proposed requirements? If not, why?

- We agree that the presentation requirements dealing with the "own credit" issue should be amended as soon as possible. However, we believe that the amendment should be mandatory and timed in alignment with the "own credit" change planned for IFRS to ensure comparability of financial reporting.
- To advance the resolution of this issue in IFRS, we have suggested that the IASB consider dealing with the "own credit" issue as an amendment to IAS 39 rather than through the early application of a portion of IFRS 9.
- We also believe that the FASB and IASB proposals in regards to "own credit" should be aligned through the elimination of the GAAP difference in which the recycling of own credit gains and losses upon settlement only will be permitted under U.S. GAAP. However, we believe that the FASB approach is more appropriate as we believe that most users would be of the view that realized "own credit" gains and losses are best represented in net income. We believe that this point should be considered in the FASB's and IASB's continued discussions concerning convergence.

Question 31: Should the effective date be the same for both public entities and nonpublic entities?

- We believe that the effective date should be the same for public and non-public entities. Since the definition of a public entity in the FASB ED will not necessarily capture all U.S. banking subsidiaries of foreign banks, we believe that the effective date should be the same for public and non-public entities. Otherwise it is possible that during the period between the effective dates of the standard for public and non-public entities, a U.S. subsidiary with local regulatory filing requirements that is considered non-public in the context of the standard will file with its regulators on a basis that is not comparable with that of its public domestic peers filing with the same regulators.
- A potential solution to this comparability issue is to expand the definition of a public entity by shortening the third criterion to "Its financial statements are filed with a regulatory agency."
- We also believe that the effective date should be aligned with the effective date for the IASB proposals related to classification and measurement. Otherwise during the period between when the public parent adopts IFRS 9 and the US subsidiary adopts the FASB proposals related to classification and measurement, the parent company will be required

to undertake a more complex GAAP conversion as part of the process of preparing its consolidated financial statements.

Question 32: How much time is needed to implement the proposed guidance?

- As a result of the complexities associated with the classification and measurement guidance and the interrelationship with the impairment and hedge accounting guidance (some of which are also in flux), we believe that the effective date should be at least 3 years from the date the classification and measurement and impairment guidance are finalized to allow for reasonable preparation time.
- As noted in question #31 above, we also believe that the effective date should be aligned with the effective date for the IASB proposals related to classification and measurement.

Question 33: Are the transition provisions in this proposed Update operable? If not, why?

- We believe that the transition proposals are operable.
- We note that convergence with IFRS would be enhanced if the transition provisions
 required restatement of the comparative periods, rather than a cumulative adjustment to
 the statement of financial position (including retained earnings and the other component
 of equity) at the beginning of the period of adoption. However, this particular difference
 between IFRS and U.S. GAAP should not impose undue operational difficulties.

Question 34: The proposed amendments would require investments that qualify for the equity method of accounting in Subtopic 323-10, Investments-Equity Method and Joint Ventures-Overall, to be subsequently measured at fair value with changes in fair recognized in net income if the investment is not held for sale at initial recognition. Are the proposed indicators/conditions operable? If not, why? What would you propose instead?

- We are supportive of the proposed amendments to eliminate the fair value option for equity-method investees, and to introduce held-for-sale criteria for these investments.
 The proposed amendments would help to achieve a greater level of convergence with IFRS in these areas.
- We note that the proposed amendments would still give rise to differences with IFRS. For example, under the proposals we expect that equity-accounted investments would meet the criteria for held for sale earlier than under IFRS 5, Non-current Assets Held for Sale and Discontinued Operations. Earlier classification as held for sale under the FASB ED could occur, for example, when an entity has identified potential exit strategies and has a defined time at which it expects to exit that is greater than one year. However, under IFRS 5, the held for sale criteria would not be met as IFRS 5 generally requires, among other things, that a sale should be expected to qualify for recognition within one year from the date of classification. In addition, under IFRS 5, the held for sale assessment is ongoing rather than only upon initial recognition as is the case under the FASB ED, and IFRS 5 requires the reclassification out of held for sale if the criteria are no longer met, whereas the FASB ED would not permit reclassification if the held for sale criteria are met upon initial recognition.
- We note that convergence with IFRS would be enhanced if the FASB instead included equity-method investees within the scope of ASC Subtopic 360-10 as this guidance is largely converged with IFRS 5.

Question 35: The proposed amendments would change the current two-step impairment model for equity method investments to a one-step impairment model for all equity investments. Do you

agree with the proposed one-step equity impairment model? If not, why? What would you propose instead?

- We do not agree with the one-step impairment model and believe that the recoverable amount concept should be permitted under U.S. GAAP for the assessment of impairment of equity method investments.
- We note that the proposed one-step impairment model includes indicators of impairment that are similar to the indicators of impairment under IAS 39 under which equity-method investees are assessed under IFRS. However, it appears that under the proposed FASB ED, impairment would be automatically recognized to the extent that fair value is calculated and determined to be below the carrying amount. Based on the first sentence in 323-10-35-31A that indicates "an investment in an equity method investee is impaired if it is more likely than not that the fair value of the investment is less than its carrying value", fair value may be required to be calculated even when the triggers are not met if it is likely that fair value is below cost (such as in a general market downturn that still does not breach the more severe impairment triggers).
- In contrast, under IFRS an impairment results only when the decline in fair value is significant or prolonged or when there is otherwise objective evidence of impairment. In addition, under the principles in IAS 36, Impairment of Assets, which are also included in paragraph 42 of IAS 28, Investments in Associates and Joint Ventures, the quantum of the impairment is based on recoverable amount, defined as the higher of the fair value less costs to sell and value-in-use.
- As a result, we believe that the proposed impairment model would result in increased volatility in earnings under U.S. GAAP relative to the IASB impairment model. This volatility may not be consistent with the longer term nature of investments typically accounted for using the equity method.
- We also believe that the IASB approach is preferable because it is more conceptually
 aligned with the approach applicable to goodwill impairment under both U.S. GAAP and
 IFRS. Therefore, it would enhance the comparability of net income resulting from
 consolidated investments and those accounted for using the equity method.

Question 36: Do you agree that the current portfolio-wide option for not-for-profit entities, other than health care entities, to account for their equity method investments at fair value should be retained? If not, why? Should that option also be made available to not-for-profit health care entities that are within the scope of Topic 954, Health Care Entities?

• We have no comment on this question.

Question 37: The proposed amendments would eliminate the fair value option for hybrid nonfinancial instruments in current U.S. GAAP and would provide a new fair value option for hybrid nonfinancial liabilities. For a hybrid nonfinancial liability, an entity would apply the bifurcation and separate accounting requirements in Subtopic 815-15 and account for the embedded derivative in accordance with Topic 815. The financial liability host that results from separation of the nonfinancial embedded derivative would be subject to the proposed amendments. However, an entity would be permitted to initially and subsequently measure the entire hybrid nonfinancial liability at fair value (with changes in fair value recognized in net income) if after applying Subtopic 815-15 the entity determines that an embedded derivative that requires bifurcation and separate accounting exists. In contrast, for a hybrid nonfinancial asset the proposed amendments would require the hybrid contract to be measured at fair value (with changes in fair value recognized in net income) if the hybrid nonfinancial asset contains an embedded derivative that would have required bifurcation and separate accounting under

Subtopic 815-15. Do you agree with the proposed amendments? If not, why? What would you propose instead?

• We have no comment on this question.