May 29, 2013

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

File Reference: No_ 2012-260 *Financial Instruments- Credit Losses (Subtopic 825-15)*

Dear Sir/Madam:

I appreciate the opportunity to offer a few comments on the Board's exposure draft, *Financial Instruments – Credit Losses* (the ED).

I applaud the Board's efforts to examine the issues surrounding the accounting and reporting for financial instruments and offering a revised approach for determining the related inherent credit losses. I am certain that users of financial information will benefit greatly from a single unified model for assessing, recognizing, measuring, and reporting such credit losses, as compared with the multiple approaches that currently exist.

Currently, I am an Associate Professor of accounting at Hofstra University; however, my comments are based on my earlier professional experience, both as a Vice President in the accounting policy department of a major New York commercial bank, which is one of the institutions absorbed into JP Morgan Chase company, and also, immediately prior to my banking assignment, as a member of the staff of the FASB, where my only financial instrument related project was accounting for collateralized mortgage obligations. That project resulted in the issuance of a staff technical bulletin that has since been superseded.

Of course, my experience as a banker and as an FASB staff member occurred over 20 years ago (mid-1980s and into the early 1990s), but even then, we were challenged by the many complexities associated with transactions involving financial instruments and financial institutions.

In general, I support the goal of developing a single model for assessing, recognizing, measuring and reporting credit losses for financial assets. However, I am not persuaded that the "expected loss" model will prove effective at improving the information provided to users of financial statements. I believe the approach introduces too much subjectivity in the recognition and measurement of credit losses related to financial assets and allows management another "tool" for managing corporate earnings.

Additionally, I am concerned that the proposed model differs from other asset impairment approaches contained in the authoritative literature, which I discuss in response to question #2.

Lastly, I am a supporter of international convergence and I am disappointed that the FASB and the IASB have offered different approaches for addressing this, admittedly, very difficult issue. So, although I do not address that issue much beyond this comment, I support a single global solution to the issues addressed by the FASB and IASB proposals.

My comments are offered with considerable respect for the Board and staff and with knowledge of the inherent challenges associated with achieving a workable solution to the issues addressed by the ED.

I am sure that most of my suggested changes have been considered by and, for one reason or another, rejected by the Board and staff, but, I appreciate the opportunity to “throw-in my 2 cents” on the off chance that something useful is contained herein.

Best regards to the Board and its staff on continued and, hopefully, successful deliberations on these difficult issues.

Sincerely,

Rich Jones
Associate Professor
Department of Accounting, Taxation, and Legal Studies in Business
Frank G. Zarb School of Business
Hofstra University
(516)463-6990

Comments on Specific Questions Contained in the Exposure Draft

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

Comment: Yes, I agree with the scope of the ED and would even accept including in the scope financial assets that are reported at fair value through net income. Such an all-inclusive approach would separate the credit loss component of the fair value adjustment for those assets from the other market-based influences on fair value and require recognition of all credit-based losses in a single manner.

Obviously, I recognize the difficulties associated with separating the credit-loss component of the fair value adjustment from the other market-based influences, such as interest-rate fluctuations. But, such factors do not differ between fair value financial instruments for which the adjustment flows through equity and fair value financial instruments for which the adjustment flows through net income. So, it seems to me the related expected credit-loss adjustment should be reported, and particularly, disclosed in the footnotes to financial statements together.

Question 2: The proposed amendments would remove the initial recognition threshold that currently exists in U.S. GAAP and, instead, view credit losses as an issue of measurement as opposed to an issue of recognition because the credit losses relate to cash flows that are already recognized on the balance sheet. Do you believe that removing the initial recognition threshold that currently exists in U.S. GAAP so that credit losses are recognized earlier provides more decision-useful information?

Comment: No. I believe that the long-term result of this amendment will have little impact on investor's available information about the "actual" credit losses inherent in the related financial instrument. Requiring the timing of recognition of credit losses based on management's or corporate credit officer's recommendations expectations of credit losses only results in reported information based on limited real knowledge about a portfolios likely performance. In essence, the Board continues to favor relevance over the now defunct conceptual framework notion of reliability.

A quick story here to make my point: during my 5 years in banking, I was assigned to work with our banking specialists to convert our multi-billion dollar emerging market portfolio, at the time called "lesser-developed country debt" or LDC loans, into more productive assets. As some of the Board members might remember, that was a very difficult challenge for the major U.S. banking institutions. Those of us who were the "young hot-shots" used to joke that many of the senior executives in our bank achieved their success during the period when those LDC loans were entered into. In fact, our CEO at the time had been the head of the banking group that built the LDC portfolio.

Anyway, legend has it that at a corporate meeting with the CEO, one of the "young hot-shots" asked the CEO whether, given the passage of time, he regretted having supported incurring such a large, back then several billion dollars was a considerable portion of our loan portfolio, bet on the LDC assets. Supposedly, he gave a very simple answer, which was, “those loans were good when I made them.” After which, he suggested that the issue be closed for discussion.

I believe the challenge created by this document is to overcome the basic weakness of senior banking managers, particularly business line managers, which is their natural optimism. They will resist establishing meaningful loan loss provisions for financial assets for which they have little history of such losses, i.e. where there is no indication of credit loss. Obviously, their accounting policy folks and, more to the facts, their credit policy folks will provide ample documentation of historical experience, when possible. But, in financial institutions, accounting and credit policy officers are not line managers, they are back office staff. Senior banking managers, particularly line managers, will not easily accept that a newly originated asset portfolio was entered into with an expectation of any meaningful level of losses. That was an issue when I was in banking, it was an issue during the recent banking crisis, and, I am certain, their natural optimism will be an issue going forward.

An additional issue that I wrestle with and I know the Board has discussed and tried to address is differentiating valuation from impairment.

In my mind, a valuation issue relates to achieving a desired or market-related return on an investment. So, for example, determining the fair value of a speculative security position refers to the required adjustment to insure that the related security achieves a market rate of return based on its underlying terms.

However, I view impairment as a liquidity/recoverability issue. When we evaluate an asset for impairment, we are trying to determine our ability to recover our recorded investment based on the cash flows (or other forms of resource recovery) over the assets remaining economic useful life.

So, I believe all models for assessing impairment should be consistent and, because in my view impairment is different from valuation, I believe the impairment assessment model should differ from approaches for assessing and recognizing market value (or fair value or whatever term is appropriate) adjustments.

Based on my reading of the exposure draft, the Board’s proposed model for assessing, recognizing and measuring credit losses on financial assets seems more similar to a fair valuation model than an impairment model.

Additionally, the Board’s proposed “expected” loss approach is not consistent with other impairment models, most of which are based on an event or condition that infers that the entity will not recover the recorded value of an asset.

Question 3: As a result of the proposed amendments, the net amortized cost on the balance sheet (that is, net of the allowance for expected credit losses) would reflect the present value of future cash flows expected to be collected, discounted at the effective interest rate. Do you agree that the net amortized cost (which reflects the present value of cash flows expected to be collected) results in more decision-useful information than currently exists under U.S. GAAP?

Comment: Yes, it's better than current U.S. GAAP. In fact, I support recognizing an amount for credit losses as a rate adjustment over the life of the financial assets as discussed in BC 14. Such an approach is consistent with the pricing of the credit. However, as discussed in the Basis of Conclusions, the Board rejected such an approach because of the various difficulties associated adoption.

Question 4: The Board has twice considered credit loss models that would permit an entity not to recognize certain expected credit losses. In the January 2011 Supplementary Document, the Board considered a model that would permit an entity not to recognize some credit losses expected to occur beyond the foreseeable future. In the recent discussions on the three-bucket impairment model, the Board considered a model that would permit an entity only to recognize lifetime credit losses for loss events expected to occur within a 12- month horizon. Instead, the proposed amendments would require that at each reporting date an entity recognize an allowance for *all* expected credit losses. Do you believe that recognizing *all* expected credit losses provides more decision- useful information than recognizing only *some* of the expected credit losses? If not, how would you determine which expected credit losses should not be recognized (for example, 12 months or similar foreseeable future horizon, initial recognition threshold, and so forth)?

Comment: No. I prefer the IASB's proposal, which requires considering only a 12-month time horizon for recognizing credit losses for financial instruments that have not yet had an event that challenges the ability of the entity to collect all of the cash flows inherent in the asset or the related portfolio of assets.

Question 5: The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets' remaining contractual cash flows. Do you believe that expected credit losses based on this information provide decision-useful information?

Comment: No, see my comments to question #2. I believe that recognizing a loss based on "expected" credit losses, absent an event that gives rise to those expected losses, will be very subjective and analysts will differ with management concerning those reported losses. Neither group, management or analysts, will be able to reliably, there's that word again, support their "guesstimate" of expected credit losses until an event occurs that clearly establishes the inherent credit losses in a specific financial asset or portfolio of financial assets.

Additionally, and this is just a hunch, I believe, and academic research certainly suggests, that eliminating the word "probable" does not eliminate the notion of probable. So, when credit officers and accountants discuss the application of the proposed guidance, they will likely base their estimates on some broad notion of probable losses inherent in the portfolio because that is the framework under which they have always operated. It's familiar to them. Now, I will not argue that their notion of "likely to occur" will match the existing concept of "probability" of losses. But, given their familiarity with that concept, I believe it will influence their "expected" loss decisions, at least until regulators, auditors, and industry practice adapts to the new guidance.

Lastly, I would argue that while financial services companies will have significant supporting information about inherent losses related to most of their consumer loan products, such as conforming mortgage loans, marine loans, and credit card portfolios, they will have difficulty developing "representationally faithful" credit losses for their a large portion of their commercial loan portfolio, which includes structured financing transactions. Such arrangements are "structured" around the nature of the project or the purpose of the funding. Often, the arrangement has many unique features that make it unlike other transactions in the commercial loan portfolio. These include real estate construction loans, corporate acquisition financing, asset-based based lending, etc. At the start of the arrangement, the lender might have little reliable information on which to determine a lifetime credit loss amount.

With respect to recoverability related to derivative financial instruments, I will plead lack of knowledge. My experience in that area is not recent enough to give a meaningful comment, except to point out that, for the most part, such markets are relatively unregulated, which limits the availability of independent third-party information on which to base credit risk evaluations, except with respect to the credit quality of the customers on either side of the transaction.

Question 6: For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be amortized into and recognized as interest income over the life of the asset. To achieve this result, upon acquisition the initial estimate of expected credit losses would be recognized as an adjustment that increases the cost basis of the asset. Apart from this requirement, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non- purchased-credit-impaired assets as bad-debt expense rather than yield. Do you believe that using the same approach to recognize changes in the credit impairment allowance for purchased credit-impaired assets and non-purchased- credit-impaired assets provides decision-useful information? Do you believe that this is an improvement from the current model used for purchased credit- impaired assets?

Comment: No comment, except that I would like the model for impairment assessment, recognition and measurement to be as uniform as possible.

Question 7: As a practical expedient, the proposed amendments would allow an entity not to recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost amount of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. The proposed amendments would require an entity to disclose the amortized cost basis of assets that apply this practical expedient each period. Do you believe that the practical expedient for some financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income is reasonable? Why or why not?

Comment: Yes. I believe impairment refers to ability to recover the recorded amount of the asset. So, I would accept an approach that argues that a financial asset with a fair value in excess of recorded cost is not impaired, but, the holder of that financial asset might be reporting increases in equity that will not be recovered in cash or other assets.

Question 8: The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially the entire principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this approach provides decision-useful information?

Comment: Yes.

Question 16: Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45– BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor's effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

Comment: Well, yes, because of my view regarding the nature of impairment.

Question 17: Do you believe the disclosure proposals in this proposed Update would provide decision-useful information? If not, what disclosures do you believe should (or should not) be required and why?

Comment: No comment.

Question 19: Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient? If not, what additional guidance or examples are needed?

Comment: Unfortunately, I have not had sufficient time to evaluate the illustrative guidance. Additionally, preparers are best able to evaluate the adequacy of the illustrative examples.

Question 20: Do you agree with the transition provision in this proposed Update? If not, why?

Comment: Again, preparers are best able to respond to this inquiry.

Question 21: Do you agree that early adoption should not be permitted? If not, why?

Comment: Yes, such an approach will promote some level of consistency of application, particularly within industry.

Question 22: Do you believe that the effective date should be the same for a public entity as it is for a nonpublic entity? If not, why?

Comment: I would support a later effective date for nonpublic entities, if the Private Company Council and the Small Business Advisory Council advocate for more time for non-public entities.