May 30, 2013

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
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Project: *Financial Instruments – Credit Losses* (File Reference No. 2012-260)

Dear Ms. Cosper:

The Mortgage Bankers Association[1] (MBA) and the CRE Finance Council[2] (CREFC) appreciate the opportunity to comment on FASB's exposure draft (ED) *Financial Instruments – Credit Losses* (Proposed Update). The stated objective of the Proposed Update is to provide financial statement users with more decision-useful information about expected credit losses on financial assets and other commitments to extend credit held by a reporting entity at each reporting date. The following are MBA's and CREFC's general observations and comments and our responses to specific FASB questions contained in the ED.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] The CRE Finance Council is the collective voice of the entire $3.1 trillion commercial real estate finance market. Our principal missions include setting market standards, facilitating market information, and providing education at all levels. Because our membership consists of all constituencies across the entire CRE finance markets, the CRE Finance Council has been able to develop comprehensive responses to policy questions that promote increased market efficiency and investor confidence.

Background

In April 2009, the G20[3], reflecting on the causes of the global financial crisis and actions that could be taken to strengthen global financial stability, recommended, among other things, that accounting principles related to loan loss provisioning be improved to permit consideration of a "broader range of credit information."[4] Many believe that the existing "incurred loss model" whereby banks record losses on loans when there is evidence that a loss has been incurred, slowed banks down in reserving for losses during the recent credit crisis. In addition, the Financial Crisis Advisory Group [5] (FCAG) recommended exploring alternatives to the existing incurred loss model that would use more forward-looking information. FASB and IASB subsequently embarked on a joint project that is re-examining accounting rules on classification and measurement and impairment of financial instruments as well as hedge accounting. The Proposed Update is FASB's latest iteration of the impairment phase of this financial instruments project. The impairment model in the Proposed Update would require reporting entities to record through profit and loss (P & L) upon origination or purchase of a financial asset an allowance for credit losses expected over the lifetime of loans, receivables and securities.

In March 2013, IASB issued its latest exposure draft, *Financial Instruments: Expected Losses* (IASB ED). The IASB impairment model differs significantly from FASB's proposed model. Rather than record credit losses upon origination or purchase of a financial asset, the IASB ED would require a "three bucket approach:

- Stage 1 – no significant deterioration in credit quality. On origination or purchase, the reporting entity would book expected shortfalls in contractual cash flows taking into account only the potential for default in the next 12 months.

- Stage 2 – significant deterioration of credit quality but no objective evidence of credit loss event. The reporting entity would book lifetime credit losses but interest revenue would still be calculated on the gross carrying amount.

- Stage 3 – Objective evidence of impairment at the reporting date. The reporting entity would book lifetime expected credit losses and calculate and record interest on the reduced carrying amount.

MBA and CREFC note that the FASB model would accomplish the G20 and FCAG goals of providing allowances for credit losses sooner than the IASB's model. But that criteria should not be determinative, and there are other attributes and criteria that are

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[3] A group of finance ministers and central bank governors from twenty major economies.
[4] *Declaration on Strengthening the Financial System*, G20, London, 2 April 2009.
[5] FCAG was created in October 2008 by FASB and the IASB as part of a joint approach for dealing with the reporting issues arising from the global financial crisis.

more important. Both models recognize losses sooner than today's model. MBA and CREFC note that an incurred loss model with a reduced probability threshold that allows the use of supportable future estimates would result in quicker loss recognition as well.

Principles for Evaluating the Two Models

MBA's and CREFC's respective members find it difficult to support one credit impairment model more than the other. Both have good points and weak points. We thus believe that it may prove useful to both FASB and IASB for us to discuss the attributes we are looking for in a final, converged model and the extent to which each of the proposed models fulfills those principles. The following are the principles MBA and CREFC used in evaluating the pros and cons of each of the models:

1. **Leads to International Accounting Standards Convergence** MBA and CREFC believe that we need one accounting model worldwide on credit impairment. Absent ultimate convergence on this issue, comparability could not be achieved when comparing one bank to another, and users would not have decision useful information.

2. **Accounting Principles Should Drive the Standard** An accounting standard should not be selected solely because it achieves a result desired by G20, FCAG, and the SEC or bank regulators. The standard should have sound accounting principles that underpin and support the standard.

3. **The Accounting Standard Should Be Operational** The accounting standard should be written in a manner that it would not require the development of a new or radically different regime to support it. It must be simple enough so that no reporting entity is "too small to comply."

4. **Comparability** The standard should be such that it promotes comparability among reporting entities to facilitate user review and analysis.

5. **Reliability of Estimates** The accounting standard should require a regime that will produce reasonably reliable estimates in the circumstances.

Review of FASB and IASB Models Based on These Principles

Principle: Leads to International Accounting Standards Convergence

The fact that, after more than three years and multiple exposure drafts, the standards are far from converged, neither model has an edge here. MBA and CREFC purposely list this principle first, because of the importance our respective members place on it.

Principle: Accounting Principles Should Drive the Standard

FASB's present incurred loss model is supported by a long-standing accounting principle. FAS 5 presently governs the recognition of loss contingencies, like credit losses. It currently requires the accrual of loss contingencies when the loss is both probable and subject to reasonable estimation. The "probable" criteria generally relates to the occurrence of an event of default or weakening of creditworthiness of the borrower. This high threshold appears to be appropriate for loss contingencies that are off-balance sheet but results in delays in recognizing credit losses on financial instruments. Under the Proposed Update there is no triggering event. Expected losses must be booked upon origination.

MBA and CREFC acknowledge the arguments made by FASB in the "Basis for Conclusions" section of the ED, but found them to be less persuasive from an accounting theory standpoint.

On March 25, 2013, FASB published a frequently asked questions document (FAQ) on the Proposed Update. FAQ question 3, item f. under "Conceptual Reasons" states in support of booking lifetime losses on day 1, "When an entity originates a loan, that entity has increased its exposure to credit losses. Likewise, when a contractual payment is received in full from the borrower, the entity's exposure to credit loss has decreased. The Board believes that recognizing all expected credit losses in the balance sheet causes the income statement to appropriately reflect the economic phenomenon that has occurred – namely, the extent to which an entity has increased or decreased its exposure to credit risk during the period."

The key underlying accounting principles issues in FASB's proposal relate to the matching concept and the lack of a triggering event. Perhaps there is a regime that would satisfy the need to record more reserves early in the asset's life while still allowing for some matching of revenue with expense. Under FASB 5 the term "probable" seems most problematic. FASB and IASB may want to consider reducing the threshold to "reasonably possible" or "more likely than not" and the time horizon to the "foreseeable future" instead of life of loan for on-balance sheet exposures. At least there would be a FAS 5 triggering event and a time horizon for longer-term assets that would allow for more precise estimates.

FASB's credit impairment model does appear to be more responsive to G20 and other pressures to record more reserves through the cycle than it does to traditional accounting principles. If recording credit losses on financial instruments on day 1 becomes the new principle, changes to FAS 5 should be limited to this area. The regime for recording losses on other contingencies does appear to be working and should be retained. FAS 5 principles should continue to be applied to other loss contingencies other than credit reserves on financial instruments.

Our respective members believe that the original IASB proposal, which called for credit losses to be recognized over the life of the asset through the effective interest rate and

to record any changes to the original loss estimate when those changes occur, was probably the most faithful model with respect to the "matching concept" in generally accepted accounting principles (GAAP). However, most respondents in their respective comment letters stated that such a regime was not operational.

IASB's proposal to book losses under the three bucket approach will result in a "lumpy" reserve pattern that, although slightly more faithful to the matching concept, is not a panacea with respect to matching revenues and expenses. The stage 2 and stage 3 recognition of losses is faithful to the FAS 5 concept of recording based upon a triggering event.

Neither the FASB's nor the IASB's respective credit impairment models are compelling from an accounting principles standpoint. MBA's and CREFC's members have divergent views with respect to the proposed models, but most of our members believe that there should be a triggering event prior to loss recognition.

Principle: The Accounting Standards Should Be Operational

One of the things the vast majority of our respective members agree upon is that FASB's model generally is operational and will enable preparers to utilize existing systems and infrastructure to a great extent. Thus, there is less chance for a reporting entity to be "too small to comply." The operational flexibility in the FASB model relates to the recognition that an estimate of expected losses reflecting the time value of money can be done implicitly. Page 23 (ASC 825-15-55-3) states, "Other methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of amortized cost written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic (after updating it for current conditions and reasonable and supportable forecasts of the future) to the amortized cost basis as of the reporting date …"

That paragraph goes on to state, "Such methods may include loss rate methods, roll-rate methods, probability-of-default methods and a provision matrix method using loss factors."

Most preparers utilize at least one of these regimes in their present analysis of allowances for credit losses. MBA and CREFC recommend that the final rule explicitly state that these methods are acceptable so that the implicit modeling techniques are codified in the final standard.

MBA and CREFC respective members believe that IASB's model is clearly less operational than FASB's. Most notably, tracking and accounting for loans and securities as they move back and forth through the stages will be difficult and will require significant changes in existing systems, staffing and infrastructure. One such difficulty will be moving back and forth from an asset level unit of account to a homogeneous pool unit of account. Tracking loans in stage 2 where interest is accrued on the gross receivable, and then tracking and recording interest on loans in stage 3 where interest is

accrued on the net loan amount will be difficult for at least U.S. reporting entities because the systems and infrastructure in use today do not support this regime.

MBA and CREFC especially believe that IASB's proposal would be unduly burdensome for small community banks in the United States.

Principle: Comparability

FASB's model is very straight-forward from a comparability standpoint. Reporting entities book all expected credit losses on the day they originate or buy a financial instrument. This takes away any incurred-loss triggers and any issues related to the forecasting time horizon. There obviously could still be some differences in the estimation processes themselves and to what extent one reporting entity uses future projections. This could lead to lack of comparability on long-term financial instruments especially the losses in the out years.

There are areas of judgment in both models. However, there is more room for differences in estimations made under the IASB model since there is judgment used in terms of the triggers for each of the three stages. Like the FASB model, the IASB model is still open to some differences in the estimation processes themselves and to what extent one reporting entity uses future projections.

Principle: Reliability of Estimates

The FASB model would require reporting entities to estimate lifetime expected credit losses upon purchase or origination of a financial instrument. The greatest challenge to providing such estimates would be for performing financial assets soon after purchase or origination (and prior to seasoning of the portfolio). This becomes even more difficult if the asset has a lengthy expected life. Thus, it should be easier to estimate losses on assets such as one year commercial loans and auto loans. However, residential mortgage assets have a term of usually 30 years, and an expected life of seven to ten years, given prepayments. Commercial real estate loans frequently have original maturities of up to ten years. In a ten-year period of time you can have two or three interest rate cycles and perhaps a major credit cycle. Clearly, in estimating fair value, a reporting entity does include credit risk as one of the factors it uses in a Level 3 estimate, but those estimates must be modeled such that they simulate what assumptions other market participants are using, and those estimates could be based primarily on the existing market or status quo.

Therefore, MBA and CREFC believe that booking lifetime expected losses on day 1 for mortgages and private label MBS will be less reliable under the FASB model. This is directly a result of the length of the estimate period.

The IASB model would likely result in more precise estimates. Although the IASB model requires lifetime expected loss estimates, many of those estimates would be made after the passage of some time and, for many financial instruments, be based on

actual defaults or credit weakening. Thus, the IASB model has the edge with respect to reliability of the estimates.

Other General Comments

Expected Loss Estimate to Reflect the Time Value of Money

Page 15 of the ED (ASC 825-15-25-4) states, "An estimate of expected losses shall reflect the time value of money either explicitly or implicitly. If an entity estimates expected credit losses using a discounted cash flow model, the discount rate utilized in that model shall be the financial asset's effective interest rate." Page 23 of the ED (ASC 825-15-55-3) drills down on what is meant by "implicitly" in ASC 825-15-25-4, "Other methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of the amortized cost amount written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic (after updating it for current conditions and reasonable and supportable forecasts of the future) to the amortized cost balance as of the reporting date to estimate the portion of the recorded amortized cost basis that is not expected to be covered because of credit loss."

FASB's FAQ on the Proposed Update provided more clarity in the use of implicit models that reflect the time value of money. MBA and CREFC agree with the response to question 16, which states:

> The Board believes entities should be permitted to utilize estimation techniques that are based on historical writeoff experience. The Board believes that those approaches implicitly reflect the time value of money, albeit in a different way than when an entity uses an explicitly discounted cash flow technique. The amortized cost amount recognized on the balance sheet explicitly reflects the present value of contractual interest and contractual principle, this historic writeoff amount also reflects the present value of contractual interest and contractual principal not expected to be collected.

The FAQ question 18 adds further clarity, "When a financial asset is initially recognized under the proposed classification and measurement guidance, the asset is recognized at either transaction price or fair value. Conceptually, the Board believes that both of these initial measurement approaches reflect a present value as opposed to a principal amount."

The FAQ question 16 also provides more certainty to preparers in the use of implicit cash flow models. It states, "An entity would not be required to prove that a method that *implicitly* reflects the time value of money … provides the same result as (or reconciles with) a method that *explicitly* reflects the time value of money." So that there is no later misunderstandings between preparers of financial statements and their auditors, **MBA and CREFC recommend that FASB codify the above quote in the final standard.**

Loss Estimate Definition

The Proposed Update requires reporting entities to reflect both the possibility that a credit loss results and the possibility that no credit loss results, and credit losses cannot be recorded solely on the basis of the most likely outcome. In some situations when an individual asset has been evaluated, the most likely outcome is considered to be a reliable estimate.

On what basis would we assume for loans and securities backed by the U.S. government the possibility that a credit loss results? MBA and CREFC recommend that FASB put in the final rule a de minimus exception whereby, for an entire asset class like U.S. Treasury securities or Ginnie Mae MBS, the highest probability of default still results in an immaterial loss that need not be recorded.

Judgment should be deemed the most appropriate basis in most circumstances, and a statistical mode, if used, should be only one of many items considered in the overall judgment. MBA and CREFC note that the myriad of loss estimation techniques and regimes mentioned in the ED should allow entities of all sizes the latitude they need to do the estimates in the most appropriate and cost efficient manner.

Model Should Be Applied to Amortized Cost Assets Only

FASB Staff Position 115-2 (FSP 115-2). *Recognition and Presentation of Other-Than-Temporary Impairment,* is presently used to determine whether the holder of an investment in a debt security for which changes in fair value are not regularly recognized in earnings, such as available for sale securities, should recognize a loss through earnings when the investment is impaired. MBA and CREFC also note that this model was enhanced by FASB in response to the credit crisis resulting in more losses recognized in a timely fashion. MBA's and CREFC's respective members believe that this accounting standard, as revised, is "not broken and should not be fixed." MBA and CREFC further note that under FSP 115-2, the reporting entity has already taken the full fair value change through equity, and the reduced carrying amount is reflected in the balance sheet. Readers should be indifferent as to the causes of the change in fair value. Accordingly, we recommends that FASB consider the use of the Proposed Update for financial instruments classified and accounted for at amortized cost and use FSP 115-2 guidance for financial instruments held for contractual cash flows or sale.

Proposed 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 (practical expedient)[6].

MBA and CREFC note that the fair value is impacted by many factors outside credit risk, especially interest rate risk. We also note that for financial instruments of high credit quality, most of the changes in fair value do relate to interest rate risk. Thus, the practical expedient is not operational because it would force reporting entities to perform expected loss analysis more frequently when rates rise and the fair value of an instrument goes down as a result. This "cliff effect" could cause dramatic changes in the workload of reporting entities resulting from changes in the yield curve as opposed to any underlying changes in credit risk.

MBA and CREFC recommend that the practical expedient be changed to read "…when [remove "both"] … (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost amount of the financial asset **or** (b) the expected credit losses on the individual financial asset are insignificant.

Proposed Non-accrual Policy

Page 16 of the ED contains the proposed non-accrual policy:

> **825-15-25-10** An entity shall cease its accrual of interest income when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest.
>
> a. If it is not probable that the entity will receive payment of substantially all of the principal, the entity shall recognize all cash receipts from the debt instrument as a reduction in the carrying amount of the asset. When the carrying amount has been reduced to zero, additional payments received are recognized as recoveries of amounts previously written off (that is, recorded as an adjustment to the allowance for expected credit losses) with any excess recognized as interest income.
> b. If it is probable that the entity will receive payment of substantially all of the principal but it is not probable that the entity will receive payment of substantially all of the interest (which may be the case if the value of collateral exceeds the amortized cost basis), the entity shall recognize interest income on the debt instrument when cash payments are received. Cash receipts that exceed the amount of interest income that would have been recognized in the period had the asset not been placed on nonaccrual status shall be applied to reduce the carrying amount of the asset.

MBA and CREFC note that the above non-accrual regime will force reporting entities to develop and maintain two separate interest accrual accounting systems, one for cost recovery method and one for cash basis reporting. Commercial real estate lenders will especially have difficulty with this. We also note that most often the contractual loan documents provide the creditor the right to apply cash received first to outstanding interest due, making the application of alternative b above to be rare.

MBA and CREFC note that bank call report guidance allows banks to use cash basis accounting once financial instruments are written to a carrying value that is deemed to

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[6] FASB, *Financial Instruments – Credit Losses*, page 7.

be collectible. We recommend that FASB amend this section in the final rule so that reporting entities have the option to use cash basis accounting to recognize interest income once the carrying value is deemed collectible.

Troubled Debt Restructurings (TDRs)

Page 149 of the ED states:

> BC47. The Board believes that when a creditor modifies a debt instrument in a troubled debt restructuring, it forgoes its unconditional right to the original contractual cash flows and, instead, accepts a modified series of contractual cash flows as what constitutes the legal contractual arrangement with the borrower. Consistent with the writeoff principle in the proposed amendments (that is, when there is no reasonable expectation of recovery), the Board decided that when an entity executes a troubled debt restructuring, the cost basis of the asset should be adjusted so that the effective interest rate (post-troubled debt restructuring) is the same as the original effective interest rate, given the new series of contractual cash flows. The basis adjustment would be calculated as the amortized cost basis before modification less the present value of the modified contractual cash flows (discounted at the original effective interest rate). The Board believes that this approach avoids the need for a special model for troubled debt restructurings and simplifies the resulting guidance.

MBA and CREFC note that some loan modifications actually increase interest rates. As a result, the Proposed Update would result in recognition of an increase in value which we believe is inappropriate.

As a practical expedient and consistent with loans not in a TDR, MBA and CREFC recommend that reporting entities should have the option of measuring impairment by the fair value of the collateral.

On a more global basis, the TDR regime does not exist in IFRS. MBA and CREFC believe that under the Proposed Update, FASB no longer needs to maintain a TDR framework. The Proposed Update prescribes a one-size-fits-all financial instruments credit impairment accounting regime, and special treatment need not be carved out for modified financial instruments.

MBA and CREFC appreciate the opportunity to share their observations with you. Any questions about the information provided herein should be directed to Jim Gross, MBA's Vice President Financial Accounting and Public Policy and Staff Representative to MBA's Financial Management Committee, at (202) 557-2860 or jgross@mortgagebankers.org or Martin Schuh, CREFC's Vice President Legislative and Regulatory Policy, at (202) 448-0853 or MSchuh@crefc.org.

Sincerely,

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Appendix A – Response to Select FASB Questions

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?

Response: MBA and CREFC believe the scope of the Proposed Update should be limited to assets carried at amortized cost. See General Comment above titled *Model Should Be Applied to Amortized Cost Assets Only.*

Question 9: 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 collectability of the financial assets' remaining contractual cash flows. Do you foresee any significant operability or auditing concerns or constraints in basing the estimate of expected credit losses on such information?

Response: See our analysis above comparing FASB's Proposed Update with IASB's proposed model. MBA and CREFC agree with using historical loss experience, current conditions, and reasonable and supportable forecasts. However, residential mortgage assets have a term of usually 30 years, and an expected life of seven to ten years, given prepayments. Commercial real estate loans can have contractual lives of up to ten years. In a ten-year period of time you can have three interest rate cycles and perhaps one credit cycle. Therefore, MBA and CREFC believe that booking lifetime expected losses on day 1 for mortgages and private label MBS will be less reliable under the FASB model. This is directly a result of the length of the estimate period.

Question 10: The Board expects that many entities initially will base their estimates on historical loss data for particular types of assets and then will update that historical data to reflect current conditions and reasonable and supportable forecasts of the future. Do entities currently have access to historical loss data and to data to update that historical information to reflect current conditions and reasonable and supportable forecasts of the future? If so, how would this data is utilized in implementing the proposed amendments? If not, is another form of data currently available that may allow the entity to achieve the objective of the proposed amendments until it has access to historical loss data or to specific data that reflects current conditions and reasonable and supportable forecasts?

Response: The operational flexibility in the FASB model relates to the recognition that an estimate of expected losses reflecting the time value of money can be done implicitly. Page 23 (ASC 825-15-55-3) states, "Other methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of amortized cost written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic (after updating it for current conditions and reasonable and

supportable forecasts of the future) to the amortized cost basis as of the reporting date …"

That paragraph goes on to state, "Such methods may include loss rate methods, roll-rate methods, probability-of-default methods and a provision matrix method using loss factors."

> Most preparers utilize at least one of these regimes in their present analysis of allowances for credit losses. MBA and CREFC recommend that the final rule explicitly state that these methods are acceptable so that the implicit modeling techniques are codified in the final standard. We believe that most reporting entities, large and small, have historical loss data. De novo institutions or institutions entering into origination or purchase of financial instruments not previously held will have to rely on external historic loss data until sufficient data is collected on their own portfolios over time.

Question 11: The proposed amendments would require that an estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results. This proposal would prohibit an entity from estimating expected credit losses based solely on the most likely outcome (that is, the statistical mode). As described in the Implementation Guidance and Illustrations Section of Subtopic 825-15, the Board believes that many commonly used methods already implicitly satisfy this requirement. Do you foresee any significant operability or auditing concerns or constraints in having the estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results?

Response: See general comment above titled *Loss Estimate Definition.*

Question 12: The proposed amendments would require that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly. Methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of the amortized cost amount written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic to the amortized cost balance as of the reporting date to estimate the portion of the recorded amortized cost basis that is not expected to be recovered because of credit loss. Such methods may include loss-rate methods, roll-rate methods, probability-of-default methods, and a provision matrix method using loss factors. Do you foresee any significant operability or auditing concerns or constraints with the proposal that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly? If time value of money should not be contemplated, how would such an approach reconcile with the objective of the amortized cost framework?

Response: MBA and CREFC agree that an estimate of expected credit losses reflecting the time value of money can be performed explicitly or implicitly. Many of the implicit methods suggested in the Proposed Update are presently utilized by preparers,

and that will operationally facilitate movement to an expected loss model. MBA and CREFC recommend that the final rule explicitly state that these implicit methods are acceptable so that the implicit modeling techniques are codified in the final standard.

Question 13: 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 recognized as interest income. Apart from this proposal, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for expected 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 foresee any significant operability or auditing concerns or constraints in determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition?

Response: MBA and CREFC believe that preparers should be able to reasonably estimate the purchase discount related to credit losses vs. discounts associated with other factors such as interest rate.

Question 14: As a practical expedient, the proposed amendments would allow an entity to not 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 basis of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. Do you foresee any significant operability or auditing concerns or constraints in determining whether an entity has met the criteria to apply the practical expedient or in applying it?

Response: See general comment above titled *Proposed Practical Expedient.*

MBA and CREFC note that the fair value is impacted by many factors outside credit risk, especially interest rate risk. We also note that for financial instruments of high credit quality, most of the changes in fair value do relate to interest rate risk. Thus, the practical expedient is not operational because it would force reporting entities to perform expected loss analysis more frequently when rates rise and the fair value of an instrument goes down as a result. This "cliff effect" could cause dramatic changes in the workload of reporting entities resulting from changes in the yield curve as opposed to any underlying changes in credit risk.

MBA and CREFC recommends that the practical expedient be changed to read "… when [remove "both"]…(a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost amount of the financial asset **or** (b) the expected credit losses on the individual financial asset are insignificant.

Question 15: 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 all of the 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 proposal will change current practice? Do you foresee any significant operability or auditing concerns with this proposed amendment?

Response: See general comment above titled *Proposed Non-accrual Policy.*

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?

Response: See general comment above titled *Troubled Debt Restructurings (TDRs).*

Question 18: Do you foresee any significant operability or auditing concerns or constraints in complying with the disclosure proposals in the proposed Update?

Response: MBA and CREFC note that page 20 (ASC 825-15-50-12) requires a reporting entity to provide a roll forward of debt instruments classified at amortized cost starting with beginning amortized cost. However, the roll forward items listed in ASC 825-15-50-12 seem to anticipate a roll forward of principal not amortized cost since there are no suggested line items for amortization or accretion. We recommend that FASB provide clarity on this proposed disclosure.

In addition, page 21 (ASC 825-15-50-17 d.) requires disclosure of "The amortized cost of debt instruments on nonaccrual status for which there are no related expected credit losses as of the reporting date because the debt instrument is a full collateralized collateral dependent financial asset." MBA's and CREFC's respective members are confused by this. Does "fully collateralized" mean that the reporting entity expects to recover the carrying amount or does it mean that the reporting entity expects to recover carrying amount plus interest?

MBA and CREFC further note that page 22 (ASC 15-50-20) requires disclosure of significant changes to the extent collateral secures financial assets, whether by general deterioration or some other reason. We notes that this is in addition to the qualitative disclosure requirement regarding significant changes to estimate credit losses (which

presumably would scope in projected changes in collateral). We are concerned that these new disclosures may result in auditors requiring periodic updated appraisals or brokers price opinions (BPOs) on large portfolios of single family mortgages that are performing. MBA and CREFC recommend that FASB be more specific in its language so that these disclosures be qualitative in nature and not require costly and time consuming loan level underwriting update exercises.

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?

Response: MBA and CREFC believe the implementation guidance and examples are appropriate in the circumstances.

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

Response: MBA and CREFC agree with the use of a cumulative effect adjustment. With that said, however, we believe certain of the transition provisions even using cumulative effect adjustment regime, could be very time consuming. For example, coming up with a cumulative effect adjustment for purchased credit impaired assets will almost require the work entailed in a retroactive restatement regime. Likewise, applying the proposed non-accrual regime will be time-consuming and cumbersome.

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

Response: MBA and CREFC agree that early adoption should not be permitted. The changes in the Proposed Update coupled with the proposed changes for classification and measurement will affect a significant number of line items in the financial statement. If early adoption were allowed, it would adversely impact comparability when comparing one reporting entity with others in the 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?

Response: MBA and CREFC favor providing additional time to smaller reporting entities.