

May 30, 2013

Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
Via email: director@fasb.org

RE: File Reference No. 2012-260: Financial Instruments – Credit Losses

Dear Chairman Seidman:

BanqLogix, Inc. ("BanqLogix") appreciates the opportunity to comment on the Exposure Draft Financial Instruments – Credit Losses. BanqLogix provides consulting services and software solutions primarily to community banks of all sizes and charters.

BanqLogix appreciates the hard work of the Financial Standards Board and recognizes that no single proposal will meet the expectations of all stakeholders. We hope that our participation in this process assists in identifying opportunities to strengthen current accounting guidance while at the same time retains some of the strong principles that are currently in place. We have drafted this letter in a manner that we feel is most beneficial for the reader, by adding an introductory section and then addressing each of the individual questions presented on the Exposure Draft ("ED") separately; because we perform several roles for our clients we will respond to the questions from all perspectives: users, preparers and all respondents.

Introduction. The Current State

The industry has made tremendous progress in the past few years in optimizing a model that may not be perfect for all situations; it is consistent with the current accounting framework and provides useful information to readers of the financial statements. Regulatory agencies have expended dedicated some time to encouraging financial institutions to apply the standard consistently and that the potential for earnings management through the improper use of estimates has diminished.

In the aftermath of the global economic crisis, it has been argued that a delayed recognition of credit losses associated with loans and other financial instruments may have represented a weakness in the application of existing accounting standards. The weakness referred to is the delay of loss recognition until a credit loss is probable or has been incurred.

The delayed recognition has had success at encouraging financial institutions to present more useful information. In addition, the delayed recognition also attempted to significantly reduce a lack of directional consistency in varying economic environments such as deteriorated economic conditions where the allowance for credit losses decreased or remained unchanged. However, the disconnect in timing of the recognition of the credit loss may be more driven by the institution's lack of ability to timely detect when that loss became probable. As an example, let's argue that a borrower does not have sufficient global cash flows to support its current debt. Bank A has a loan to that borrower which is current and no flags have been raised to the officer. Bank B has a similar loan to the same borrower that is currently past due. It would be logical to argue that the loan in Bank A meets the definition of impairment because it is probable that Bank A will be unable to collect all amounts due in accordance with the contractual terms of the loan. It is more likely than not that the borrower will use some of the cash flows currently destined to Bank A to cover its exposure to Bank B as the latter becomes more aggressive in its collection efforts. However, Bank A has no way of knowing that information until Bank A's officers obtain the information from the borrower, Bank B's officer, the regulators, the loan is placed on the National Shared Credit Listing, or the review of financial statements resulting from debt covenants is completed (if applicable) or simply until the loan becomes past due and it is included in Bank A's monitoring reports. As you can see from this simple example, the delay in recognition was more due to Bank A's immediate ability to obtain information showing the loss was probable. Nonetheless, based on purely loan performance, there was little Bank A could have done on its own to identify the loan as troubled and recognize a provision sooner.

We believe that the current approach could remain as the basis but additional elements can be included to further strengthen the accounting. Consequently, we applaud your initiative to incorporate the concept of qualitative factors to enhance the loss rate associated with historical losses. While this concept is not new, we believe that enhancing the explanation of qualitative factors in the guidance will provide more consistency in the application of the accounting principles.

Our initial suggestion will be that the impairment model and the purchased-credit impaired model remain intact, but that focus is allocated to expand the guidance on the allowance for credit losses of loans with homogeneous characteristics currently covered under ASC 450, *Contingencies* formerly known as SFAS 5. We believe that more guidance on the use of consistent qualitative factors, comparisons to peers and determination of the loss rates will be more conducive to a stronger determination of the allowance for loan losses.

An additional suggestion would be to expand the impairment model to cover possible losses rather than probable losses. While this may be inconsistent with the current accounting framework, it would be more closely in line with the method many financial institutions monitor their portfolios. Currently, financial institutions include loans where a loss is possible in their classified portfolios although the probability has not yet materialized but those loans are evaluated with the pools of homogeneous loans due to not meeting the definition of impairment. Extending the impairment model to incorporate these loans will integrate the allowance for credit losses computation more seamlessly into the classified loans monitoring process.

Responses to specific questions presented in the Exposure Draft

The following section addresses the questions presented in the ED in the same order they are presented. For ease of reading, we have copied the question from the pronouncement and respond below it in the form of a Q&A document. In the previous section, we have provided our overall point of view, and we want to emphasize that our responses to these specific questions are not intended to conflict with our overall opinion, but rather are presented as a means to better address the Board's specific inquiries.

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?

Answer 1:

We partly disagree with the scope. The accounting for investment securities is fairly robust and the concept of other than temporary impairment has been thoroughly examined. Therefore, we believe that investment securities should be excluded from the scope of this update. On the remaining assets listed, we believe that the broad scope of financial assets included is adequate.

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?

Answer 2:

No, we disagree with this approach. We believe that the notion of impairment is a valid approach and it provides valuable information to readers of the financial statements. Our suggestion would be to expand the concept of impairment to include all adversely classified loans, including special mentioned and substandard loans.

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?

Answer 3:

We partly agree with this approach. We believe that where applicable, a present value model of expected cash flows reflects the fair value of a financial asset. However, there are certain financial assets where the use of an expected cash flow model is irrelevant because the perceived value of the asset is more directly linked to the value of the collateral supporting the financial asset than the cash flows expected to be collected. We fear that the migration of the entire credit loss computation to a present value of expected cash flows model will add complexity to the process and will remove some of the intuitive concepts familiar in the banking industry.

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)?

Answer 4:

To the extent that losses are foreseeable, we agree that a financial institution should recognize lifetime credit losses. However, this approach is not necessarily feasible and it becomes more of a "check the box" exercise than a true value added process to account for true losses. Partly this is why we believe that the impairment model still works. It is easier to identify based on the current financial information or value of the collateral of a specific loan that exhibits credit weaknesses. However, to apply the concept to loans that do not exhibit the same credit weaknesses may result confusing to the user and may result in directional inconsistency previously discussed. Our suggestion is to retain the impairment model but expand the homogeneous loans allowance to incorporate qualitative factors that address expected foreseeable losses.

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?

Answer 5:

We agree with an approach that includes all relevant information, including future events. Nonetheless, we believe it is important for the information to be factually based and specific. We would also suggest that the Board provide, as part of the implementation guidance, illustrative examples on how to apply generic information such as forecasts on economic conditions and industry statistics to better assist users with how to address this portion of the accounting guidance.

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?

Answer 6:

We believe that the concept of expected cash flows model should be extended to all financial assets acquired through the completion of a transfer, including business combinations. When an acquisition of a financial asset occurs, the acquirer is looking to the expected cash flows as a whole rather than based on the contractual cash flows. Thus, expanding the expected cash flow model to all financial assets acquired rather than using expected cash flows for loans acquired with credit deterioration and contractual cash flows for other loans acquired appears to be a more consistent approach. We do not agree with removing the yield adjustment from the expected cash flow model. That approach provides an important distinction to users of the financial statements. If all deterioration and improvement of expected cash flows were processed through the allowance it may create an offsetting effect within the allowance that may disguise the existence of more pervasive problems in the originated or acquired portfolio. Furthermore, the existence of the yield adjustment from improved cash flows represents a deterrent from overly optimistic expectations. The requirement to recognize additional yield from improved future expected cash flows over the life of the loan decreases a company's ability to manipulate earnings. The implied time constrained associated with the yield adjustment encourages companies to truly vet their assumptions to avoid unnecessary surprises. Furthermore, we would suggest that a valid change in the accounting for purchased-credit-impaired financial assets is to

eliminate the use of the reserve and make all adverse changes to expected cash flows affect the non-accretable balance for that loan.

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?

Answer 7:

As discussed in Answer 1, we believe that Investment Securities should be excluded from the scope of this update, consequently, the impact of this question may be minimal. Furthermore, we believe that if the credit loss is insignificant, entities should be allowed not to recognize the expected credit losses regardless of the type of asset and whether they are accounted for at fair value with changes recognized in other comprehensive income or somewhere else on the financial statements.

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 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 approach provides decision-useful information?

Answer 8:

Yes, we are in full agreement with this approach.

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 collectibility 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?

Answer 9:

We believe that the judgment portion of the allowance for credit losses has always represented an operational burden to management in order to complete the audit. That is why having a clear model, like the impairment model, that defines a problem asset and assists in providing the requirements for its documentation is helpful. Removing that guidance will result in diverging interpretations as to the severity of the credit problems of the financial asset. Furthermore, utilizing forecasts without clear guidance as to what type of information will be considered reasonable and sufficient may result in significant inconsistencies in the way the process is audited and will adversely affect the process that will be more directed towards pleasing the auditor than calculating the most reasonable value for the loan.

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 be 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?

Answer 10:

We believe that the range of data is vast and depends on the size of the organization. The smaller the institution, the less sophisticated their management information systems and consequently the quality of their data. As it relates to forecast information, some financial institutions may have some information related to asset liability management, but there is no clear relationship between forward looking forecast and current credit issues. Information may be available or become available, but it will be necessary to provide clear guidance on the use of forecasts to ensure that the accounting is applied consistently across organizations.

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?

Answer 11:

We do not agree with this methodology. We believe that it will create unnecessary added steps that will be completed to "check the box" rather than value added activities to determine the most reasonable credit losses for a loan. There are certain loans in which the existence of a loss is evident, so assuming no loss for that loan is unreasonable and would distort the results of the estimate. If a loss probability to be applied is zero then why invest resources in calculating it in the first place In similar fashion, there may be loans were no loss is expected. This may be either because the loan is cash collateralized or has sufficient collateral, therefore assuming a credit loss on that loan for the argument of estimating a credit loss that may not exist is not value added and creates unnecessary operational burden. We believe that the approach involving multiple credit loss results should be limited to events in which management believes that multiple outcomes are possible.

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?

Answer 12:

As discussed in our introduction, we believe that the current approach of combining an impairment model with a robust methodology that incorporates loss rates and qualitative factors better defines the critical computations to determine the allowance for credit losses. This approach appears to be consistent with the proposed amortized cost framework that is highly dependent on expected cash flow models only, and may not be reflective of the current conditions affecting troubled assets.

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?

Answer 13:

While operationally this process may appear simpler, we believe that the information that the current methodology provides has greater value than then operational savings that this proposed change provides. Furthermore, there is a possibility that as time progresses, there will be a push to provide information available under the current guidance which will be attempted to be solved via specific disclosures, negating the effect of the operational savings previously discussed. We believe that it makes more sense for the Board to work with the AICPA on issuing technical guidance and clarification, including effect of the accounting when loans are grouped in pools with similar risk characteristics.

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?

Answer 14:

Please refer to Answer 7

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?

Answer 15:

We believe that most core systems allow for financial institutions to treat loans as cost recovery or cash basis. So the full implementation of this process should not require significant investment. One amendment, however, would be to allow companies to use a cost recovery method as a practical expedient, bypassing the cash basis approach.

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?

Answer 16:

We believe that the concept of trouble debt restructurings ("TDR") is still relevant. However, we also believe that it has created significant confusion in the industry. One option would be to simplify it by limiting the concept only to loans that have experienced a change in terms that include a concession to the borrower. Nonetheless, what constitutes a concession should be spelled out to limit the amount of uncertainty currently affecting this issue. Furthermore, we believe that the TDR designation for disclosure purposes should be eliminated after the financial asset has performed in compliance with the new terms for an extended period of time such as 12 months.

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?

Answer 17:

We have no objection to the proposed disclosures.

Question 18:

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

Answer 18:

We believe that some of the information may require significant investment to be produced. For example, the disclosure as to forecasts will be difficult to achieve and will provide confusion. In addition some of the information required including FICO scores or collateral values are not obtained by companies on a consistent basis for all financial assets regardless of the credit quality. One suggestion would be that this type of information be presented on new originations, which is the time when that type of information is compiled and it would provide the reader of the financial statements information as to potential changes in the quality of underwriting from one accounting period to the next.

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?

Answer 19:

We believe that the information provided is practical. However, we believe that information related to the use of forecasts is limited and more information would be required to ensure a consistent application of the accounting.

Question 20:

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

Answer 20:

We have no objection with the transition provision.

Question 21:

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

Answer 21:

We do not see a reason for which early adoption should not be permitted.

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?

Answer 22:

Traditionally public entities have better access to data because of information provided in the MD&A section of their public filings. Consequently, it would be expected that public entities would have an easier time implementing the update than private companies that do not have access to the same quality of information. Thus we believe that there should be a two year lapse between public entity adoption and private entities adoption.

Question 23:

Do you believe that the transition provision in this proposed Update is operable? If not, why?

Answer 23:

We have no objection with the transition provision.

Question 24:

How much time would be needed to implement the proposed guidance? What type of system and process changes would be necessary to implement the proposed guidance?

Answer 24:

We believe that the minimum time of implementation will not be earlier than three years as companies receive training and prepare their policies and procedures to be fully compliant. We believe that current core systems cannot manage the update as it is currently proposed.

Respectfully,

Luis A. Valente, CPA Chief Executive Officer

BanqLogix, Inc.